TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM [redacted] 1927

No. [redacted] 152

F. H. MASON, PETITIONER,

vs.

C. F. BOUTZAHN, COLLECTOR OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR CERTIORARI FILED DECEMBER 14, 1926

CERTIORARI GRANTED JANUARY 17, 1927

(32,337)

(32,337)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926

No. 770

F. H. MASON, PETITIONER,

vs.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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[fol. 1] [Caption omitted]

[fol. 2]

IN UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF OHIO

PETITION—Filed December 14, 1923

Plaintiff was at the times hereinafter stated, has continued to be and now is a resident of Akron, Summit County, Ohio.

Defendant was at the times hereinafter complained of, has continued to be and now is the Collector of Internal Revenue in and for the Eighteenth District of Ohio.

First Cause of Action

Plaintiff for his first cause of action alleges and says:

1. That before and at all times during the year 1917 plaintiff was the owner and holder of record of 22,781 shares of the common stock of The B. F. Goodrich Company, a corporation duly organized and existing under the laws of the State of New York, and doing business in the State of Ohio; and before and on January 2, 1917, he was the owner of 10,010 shares, and before and on April 1, 1917, and thenceforward throughout said year, he was the owner and holder of record of 9985 shares of the 7% preferred stock of said The B. F. Goodrich Company.

2. That before October 25, 1916, said The B. F. Goodrich Company had accumulated undivided profits or surpluses more than sufficient to pay the dividends on its common stock and on its preferred stock hereinafter referred to, the amount necessary for said purposes having been accumulated by it during the calendar year 1916. And on the following dates respectively the Board of Directors of The B. F. Goodrich Company declared upon its common stock, including the common stock held by the plaintiff, cash dividends at the rate of $1.00 per share, to-wit: On October 25, 1916, a dividend payable February 15, 1917; and on January 24, 1917, a dividend payable May 15, 1917.

And on the following dates respectively The B. F. Goodrich Company declared upon its preferred stock, including the preferred stock held by plaintiff, cash dividends at the rate of $1.75 per share, to-wit: On October 25, 1916, a dividend payable January 2, 1917; on January 24, 1917, a dividend payable April 2, 1917; and on said January 24, 1917, a dividend payable July 2, 1917. Each and all of said [fol. 3] dividend distributions upon the common stock and upon the preferred stock of said Company were made from the profits or surplus of the Company accumulated during the calendar year 1916, which profits or surplus were in each case the most recently accumulated undivided profits or surplus of said corporation, and each of said dividends constituted income which was taxable to the distributees at the rates prescribed by law for the year 1916, in which such profits or surplus were accumulated by said corporation.

And the plaintiff received from said Company as and for such dividends so declared the amounts set forth in the following summary:

Stock	Date declared	Date paid	Amount received
Preferred	October 25, 1916	January 2, 1917	$17,517.50
Common	October 25, 1916	February 15, 1917	22,781.00
Preferred	January 24, 1917	April 2, 1917	17,473.75
Common	January 24, 1917	May 15, 1917	22,781.00
Preferred	January 24, 1917	July 2, 1917	17,473.75
Total of said dividends received by plaintiff			$98,027.00

3. That in due time, and in the manner and form prescribed by the Commissioner of Internal Revenue, plaintiff made a return for the calendar year ending December 31, 1917, of his annual net income for said year upon a printed form furnished to him by defendant, all as required by the Act of Congress in such case made and provided for such year. In said return plaintiff set forth as a part of his income the amounts aforesaid received by him as dividends upon his common stock and preferred stock of The B. F. Goodrich Company, to-wit the sum of $98,027.00; and in the appropriate blanks set forth and returned therein that the same were accumulated in the year 1916, and calculated and set forth the amount of the tax thereon at the rates prescribed by the Act of Congress of September 8, 1916, being the rates and amounts prescribed by law for the

year in which such profits or surplus from which such dividends were paid, were accumulated by said corporation.

4. That subsequent to the filing of said return, and in due time the Commissioner of Internal Revenue, having before him said return, assessed against the plaintiff for the year 1917 an income tax of $7,451.38, which amount in- [fol. 4] cluded the tax upon said dividends so received from The B. F. Goodrich Company at said rates prescribed for the year 1916, which said tax the plaintiff, on presentation of bill therefor, duly paid to the Collector of Internal Revenue for said district at the times during the year 1918 as required by law.

5. That on or about the 1st day of March, 1923, the Commissioner of Internal Revenue of the United States re-examined the plaintiff's said return of income, and held and decided that the plaintiff was not entitled to return the amount of said income received as said dividends from The B. F. Goodrich Company at the rates prescribed by law for the year 1916, but was taxable thereon at the rates prescribed for the year 1917; and said Commissioner thereupon amended the plaintiff's return for said year 1917, and, except for said sum of $17,517.50 so received on January 2, 1917, re-calculated said return with respect to the taxes upon said incomes received as dividends from The B. F. Goodrich Company, on the basis and at the rates prescribed by the laws of Congress in force and effect for the year 1917, and assessed against the plaintiff on said return as so amended additional taxes because of said incomes so received by way of such dividends in the sum of $12,458.60.

6. That on the 2nd day of May, 1923 the defendant presented to the plaintiff a bill for the additional taxes assessed as aforesaid and demanded immediate payment thereof under threat that unless the same were paid the property of the plaintiff would be distrained for the collection of such tax.

7. That because of such threat of distraint, plaintiff on the 11th day of May, 1923, paid said tax to defendant under written protest, asserting the illegality of the tax, denying liability therefor, and notifying the defendant that suit would be brought against him to recover the amount so paid with interest from the date of payment.

8. That thereafter in due form the plaintiff presented to the Commissioner of Internal Revenue his claim in writing for the refund of said taxes so paid to the defendant as aforesaid, on the ground that said taxes had been illegally assessed against the plaintiff, which application for refund was rejected and denied by said Commissioner [fol. 5] of Internal Revenue on the 29th day of October, 1923.

9. Plaintiff says that by reason of the foregoing there is due plaintiff from defendant the sum of $12,458.60 with interest from May 11, 1923.

Wherefore, plaintiff prays judgment against the defendant in the sum of $12,458.60 with interest from the 11th day of May, 1923 and his costs herein expended.

Horace Andrews, S. M. Jett, Attorneys for Plaintiff.

Duly sworn to by F. H. Mason. Jurat omitted in printing.

IN UNITED STATES DISTRICT COURT

PRECIPE FOR SUMMONS—Filed December 15, 1923

To the Clerk:

Please issue summons for the above named defendant, returnable according to law, and endorse same, "Action at law for money, amount claimed $12,458.60 with interest thereon from May 11, 1923, together with the costs of this action."

Horace Andrews, S. M. Jett, Attorneys for Plaintiff.

[fol. 6] IN UNITED STATES DISTRICT COURT

SUMMONS AND MARSHAL'S RETURN

Action for money only. Amount claimed: $12,458.60.
Returnable Dec. 24, 1923. Answer day: Jan. 12, 1924.
$15.00 Deposited for costs. Returned and —.
Horace Andrews, S. M. Jett, Plaintiff's Attorneys.

THE UNITED STATES OF AMERICA,
Northern District of Ohio,
Eastern Division, ss:

The President of the United States of America to the Marshal of the Northern District of Ohio, Greeting:

You are Hereby Commanded to notify C. F. Routzahn, Collector of Internal Revenue for the Eighteenth District of Ohio, that he has been sued by F. H. Mason, in the District Court of the United States, within and for the Eastern Division of the Northern District of Ohio, and that unless he answers by the 12th day of January A. D. 1923, the petition of the said plaintiff against him filed in the Clerk's office of said Court, at Cleveland, in said Division and District, such petition will be taken as true, and judgment will be rendered accordingly.

You will make due return of this summons on the 24th day of December, A. D. 1923.

Witness, the Honorable John M. Killits, and the Honorable D. C. Westenhaver, District Judges of the United States, this 14th day of December, A. D. 1923, and in the 148th year of the Independence of the United States of America.

B. C. Miller, Clerk, by C. A. Wilder, Deputy Clerk.
(Court Seal.)

Original.

[fol. 7] U. S. Marshal's Return—Filed December 26, 1923

THE UNITED STATES OF AMERICA,
Northern District of Ohio, ss:

Received this writ at Cleveland, Ohio, Dec. 14, 1923 and on Dec. 17, 1923 I served the within named C. F. Routzahn personally by serving his secretary with a true copy with all endorsements thereon.

Geo. A. Stauffer, by H. D. Lingenfelter, Dep.

Marshal dues:

Service	2.00
Travel	.06
	2.06

IN UNITED STATES DISTRICT COURT

AGREED STATEMENT OF FACTS—Filed November 29, 1924

The parties plaintiff and defendant agree to and hereby do stipulate for the purposes of this case the following facts to be true, and consent that they may constitute a part of the finding of the facts in this case without restricting either party in the introduction of further evidence.

(1) The B. F. Goodrich Company is a corporation duly organized and existing under the laws of the State of New York, and duly authorized to transact business in the State of Ohio, with its works and principal office at Akron, Summit County, Ohio. Prior to and thruout the year 1917, F. H. Mason owned and held of record 22,781 shares of the common stock of said The B. F. Goodrich Company, and prior to and until after January 2nd, 1917 said F. H. Mason owned and held of record 10,010 shares of the 7% preferred stock of said The B. F. Goodrich Company, and prior to and on April 2nd, 1917, and thenceforward he was the owner of record of 9,985 shares of said 7% preferred stock of said Company.

[fol. 8] (2) That during the year 1916 and for many years prior thereto The B. F. Goodrich Company had been actively engaged in the manufacture of rubber equipment, articles, goods, and supplies, and had earned and accumulated, and on December 31st, 1916, held, large undivided profits and surplus, the portion of which accumulated during the year 1916 was more than sufficient to pay the dividends on its common stock, and on its preferred stock, which were paid by it to its common and preferred stockholders at the times during the year 1917 hereinafter set forth, from January 2nd, 1917 to July 2nd, inclusive.

(3) That dividends were declared and paid by The B. F. Goodrich Company to the holders of its common stock, including F. H. Mason, at the rate of $1.00, per share for each dividend, as follows to-wit:

Date of Declaration	Date of Payment
October 25th, 1916.	February 15th, 1917.
January 24th, 1917.	May 15th, 1917.

and that dividends were declared and paid by The B. F. Goodrich Company to the holders of its 7% preferred stock at the rate of $1.75 per share of said stock for each such payment as follows, to-wit:

Date of Declaration	Date of Payment
October 25th, 1916.	January 2nd, 1917.
January 24th, 1917.	April 2nd, 1917.
January 24th, 1917.	July 2nd, 1917.

(4) That F. H. Mason received from said dividends so declared by The B. F. Goodrich Company the following amounts, to-wit:

On its Common Stock:

On February 15th, 1917	$22,781.00
On May 15th, 1917	22,781.00

On its Preferred Stock:

On January 2nd, 1917	$17,517.50
On April 2nd, 1917	17,473.75
On July 2nd, 1917	17,473.75

making an aggregate amount received by him from the dividends so paid by The B. F. Goodrich Company to the holders of its common stock and the holders of its preferred stock, on the dates hereinabove set forth, of $98,027.00.

[fol. 9] After July 2nd, 1917, said Company paid other dividends on its stock, but such subsequent dividends are not here involved.

(5) Prior to, and including the year 1917, approximately 75% of the Company's output was made up of rubber tires for motor vehicles. Thruout all that period closed automobiles had not come into general use, and the great majority of automobiles were open cars. A very large percentage of such cars were laid up during the winter season, so that the rubber tire business of the Company was seasonal in its nature—the large volume of such business being done with the public during the summer months. As a result, the Company, in order to maintain its production on a fairly even basis thruout

the year, had stored in its warehouses at its Akron plant a very large part of its output made during the fall, winter and spring months, and the storage of these tires required and consumed large storage space.

(6) Late in the year 1916 the officers of The B. F. Goodrich Company, believing that the United States would shortly be involved in the European war, tendered its manufacturing facilities to the Government, and the officers of the Company promptly began preparation for such war work in accordance with instructions as to the Government's probable requirements.

In order to provide such necessary manufacturing space for war supplies, and at the same time continue, so far as possible, the production of its peace-time requirements, it was decided that the space theretofore used for winter and spring storage of tires should be made available for manufacturing operations. To accomplish this, and in order to have its tires well distributed thruout the United States in case of a shortage of shipping facilities due to the war—the Company determined to make and adopt a special arrangement under which these tires could be shipped to its dealers thruout the United States. A form of special contract was adopted for the purpose of carrying out this plan, in tenor as follows:

Goodrich Automobile Tire Dealers' Memorandum of Agreement

The B. F. Goodrich Company.

GENTLEMEN: In consideration of your giving us your lowest dealers' prices on Goodrich Brand Automobile Tires and Accessories, you may enter our order for tires and [fol. 10] accessories, under the conditions set forth hereinafter:

Stock

We agree to carry in stock at all times an assortment of the goods specified herein to anticipate the needs of the car owners whom we serve.

Advertising

We agree to inform the car owners of this locality that our store is an active unit in your chain of distribution. To help us achieve this purpose, and to aid us in uniting our store with your national advertising program, we agree to place a sign furnished by you, as indicated, prominently on our place of business. (Cut of sign inserted in original contract.)

Protection

Should any downward revision in your general dealers' prices occur within one hundred and twenty (120) days from date of invoice, any unsold cases or tubes that we may have in stock are to be adjusted by you in accordance with the new and lower basis. If we find ourselves overstocked in any sizes or types of your cases or tubes at the close of the tire season, which for the purpose of this Agreement shall be the months of September and October next following execution, we are to have the privilege of returning to your store from which purchased, all transportation charges prepaid, such surplus stock for credit at the price paid, less cash discount or any other allowance applying on the purchase price as herein provided. In no case, however, will you be expected to receive or issue credit for any stock purchased by us more than six months prior to the date of return, or for stock which, in your judgment, is not in first-class salable condition. If you desire at any time to draw upon us for stock we may have on hand, we agree, on receiving written notice, to return to you promptly, transportation charges prepaid, such surplus stock in first-class salable condition under the same provisions for credit as hereinabove provided; or, failing to do so, to relinquish the privilege of returning for credit at a later date such surplus stock in the size and type called for by you.

[fol. 11]

Price Change

We understand that you reserve the full right to alter either list or trade prices and terms at any time and without prior notice, and to refuse to sell us, except for cash, whenever you are not satisfied with our responsibility.

Acceptance

Upon your acceptance in the place provided, this Agreement shall be in full force and effect, and any and all prior or contemporaneous oral or written communications, representations, or agreements, made by any person or persons for, or on behalf of your Company or ourselves, shall be merged in this written agreement, and we will not at any time assert or claim that any terms of this agreement can be or have been altered, waived or modified, except by a written endorsement thereon signed by an executive officer of your Company. We agree that all deliveries hereunder are subject to delays caused by labor disputes, interruption or shortages of transportation facilities, accidents or any causes beyond your control.

Cancellation

This agreement expires by limitation on October 31, 1917. We agree that you may cancel this agreement without notice whenever you believe that we are violating or have violated any of its provisions or are committing or have committed any act that is directly or indirectly detrimental or injurious to your interests.

Under this special contract and arrangement the great bulk of the tires manufactured from January 1st up to July 1st, 1917, were shipped out to dealers. In the meantime, by reason of the public anticipation of the declaration of war, business conditions were unsettled, and the demand for tires wholly uncertain. The total value of the delivery of tires to dealers under said agreement during the first six months of 1917 was as follows:

January	$2,426,888 32
February	2,343,696 26
March	3,876,296 60
April	2,796,442 96
May	2,772,325 06
June	3,128,726 79

[fol. 12] (7) Between July 1st and August 1st, 1917, the demand for automobile tires increased beyond the Company's previous expectations, and to meet such demand the Company increased its factory output, and in addition,

gave notice to its dealers requesting them to determine by August 15th, 1917, whether they would keep the tires shipped to them under the special contract or would release the same and permit the Company to ship them to other customers.

(8) The adjustment of the Company's manufacturing program to the preparation for war work, required the expenditure of very large sums of money; and the operating expenses for the first half of 1917 were unusually large. In order to comply with the requirements of the Government the Company found it necessary to employ experts, to prepare plans, patterns and tools of all kinds, and to train an organization made up of thousands of persons, in the work of manufacturing balloons, gas masks, and other supplies and equipment, as to which the Company had theretofore had no experience. In doing these things the Company was required to, and did, make great expenditures; and in addition to disbursing large amounts out of its receipts, it increased its bank indebtedness on demand and short term notes between January 1st and July 1st, 1917, in an amount exceeding $13,500,000—mainly for operating expenses and materials. The net increase in plant account of the Company during said six months' period was only approximately $1,336,000. More than $8,500,000 of said borrowing was during the month of June, 1917, over $5,400,000 of which was used to pay maturing notes, given during that year, and the balance of $3,180,000 being required for the current operations of the Company.

(9) After July 15th, 1917, and before December 31st of that year, The B. F. Goodrich Company operated to the limit of its manufacturing capacity, and received large incomes and profits, sufficient to pay its outstanding notes given for operating expenses before July 1st, and to pay its entire operating expenses after that time, and in addition thereto, sufficient to leave undivided surplus and profits for said year large enough in amount to more than equal the sums paid for dividends upon its common and preferred stock thruout said entire year.

(10) On January 28th, 1918 the Company caused the following notice to be sent to F. H. Mason and to all its other stockholders:

[fol. 13] Notice to Shareholders

The attention of the stockholders is called to the fact that the dividends on the preferred stock of this Company which were paid on January 2nd, 1917, April 2nd, 1917, and July 2nd, 1917, and on the common stock which were paid on February 15th, 1917 and May 15th, 1917, were declared from the net profits accumulated in the calendar year 1916, which were the most recently accumulated undivided profits of the Company.

Yours very truly, The B. F. Goodrich Company. B. G. Work, President.

(11) In due time F. H. Mason made return for the calendar year 1917 of his annual net income for said year upon a printed blank furnished to him by the Collector of Internal Revenue at Cleveland, Ohio, for that purpose, a true copy of which said return is hereto attached marked "Exhibit A". Said return was made in good faith and under advice of counsel. In making said return F. H. Mason entered therein and reported and set out in appropriate blanks and spaces, therein provided for such purpose, the income received by him by way of dividends from The B. F. Goodrich Company, and included and reported therein said dividends received on January 2nd, 1917, February 15th, 1917, April 2nd, 1917, May 15th, 1917 and July 2nd, 1917, as paid from undivided surplus and profits of the Company accumulated by it during the year 1916, and reported and thereafter duly paid the amount of the tax based upon that part of said income represented by said dividends, at the rates prescribed by law for the year 1916.

(12) Some time before the 30th day of March, 1922, a duly authorized representative of the Treasury Department proceeded to audit the books and records of said F. H. Mason in connection with his said return for said year 1917, and made the claim and reported that except the first dividend (paid on January 2nd, 1917) the entire dividends paid by [fol. 14] The B. F. Goodrich Company to F. H. Mason during the year 1917 should be deemed to have been paid from the undivided profits or surplus of the Company for the year 1917, and not from the undivided profits or surplus of the year 1916; and that, except for said sum of $17,517.50 (the

January 2nd dividend) said F. H. Mason was not entitled to pay income taxes upon the dividends received by him from The B. F. Goodrich Company during the year 1917 at the rates prescribed by law for the year 1916, but should be required to return and pay income taxes thereon at the rates prescribed for the year 1917; and said representative of the Treasury Department also recommended that certain other small amounts, not here in question, should be taxed at the 1917 rates instead of the rates prescribed for the year 1916 as reported.

(13) Thereupon, the Commissioner of Internal Revenue made certain corrections (not here in question) of Plaintiff's said return for said year, some in favor and some against this Plaintiff, as the net result of which corrections (had they been the only changes made in said return) Plaintiff would have been entitled to a refund of approximately one thousand ($1,000) dollars on account of over-payment of income taxes for said year; at the same time said Commissioner proceeded to, and did, over the objection of said F. H. Mason, amend his return for said year, relative to all the following dividends hereinbefore referred to received by him from The B. F. Goodrich Company, to-wit: the dividend on common stock declared on October 25th, 1916 and paid on February 15th, 1917, and the dividends on preferred and common stock declared on January 24th, 1917 and paid respectively on April 2nd, 1917, May 15th, 1917 and July 2nd, 1917, as to all of which said F. H. Mason had made his return on the basis that said dividends had been declared and paid from undivided profits and surplus accumulated by said Company during the year 1916, as hereinbefore stated, so as to set forth and show that, except for the amount of $17,517.50 (being the dividend paid by The B. F. Goodrich Company as hereinbefore set forth) were from accumulated undivided surplus and profits of said The B. F. Goodrich Company for the year 1917, and said Commissioner assessed the tax thereon at the rates prescribed by law for said year 1917.

Said Commissioner thereupon proceeded to, and did, over the objection of F. H. Mason, assess against said F. H. Mason additional taxes above those originally shown on his said return and paid, as herein set forth, to the amount of $12,458.60 for the year 1917, and on or about the 30th

day of April, 1923, delivered his assessment list to the Collector at Cleveland, Ohio, who on the 2nd day of May, 1923, made demand upon said F. H. Mason for payment thereof, informing said F. H. Mason that unless said payment was made within 10 days, he would issue a distraint warrant [fols. 15 & 16] and sell the property of said F. H. Mason to pay said taxes.

Said F. H. Mason on the 11th day of May, 1923, being under compulsion and duress and solely to avoid the seizure and sale of his property, paid to said Collector said taxes under protest, stating that they were being illegally assessed and giving notice to said Collector that he intended to apply forthwith to the Commissioner of Internal Revenue for refund thereof, and if such refund were denied, to institute suit against the Collector to recover the amount so paid, with interest. A claim for refund of such taxes was forthwith presented to said Commissioner, and by him on the 29th day of October, 1923, in due form was rejected.

(14) It is agreed that if, upon the execution of the special contract between The B. F. Goodrich Company and its dealers, hereinabove set forth, deliveries of tires thereunder at once became and constituted firm sales, the Company had on the dates of payment of dividends here in question profits, earned but not received, for the year 1917 equal to or in excess of the amount of said dividends; but if the deliveries under said special contract did not constitute firm sales, the Company did not have any profits for such year on the dates of the payment of the dividends here in question. The Company kept its books on an accrual basis; and it has been the custom of the Company to treat on its books the assets represented by merchandise on consignment, as accounts receivable by the Company up to and until the time of closing its books at the end of the calendar year, at which time the amount of the accounts receivable has been reduced by the amount included therein on account of stock then remaining on consignment, and the inventory of finished goods increased by the inventory value of such merchandise; and the goods shipped during the year 1917 under the special contract hereinbefore referred to were dealt with by the Company on its books in this manner.

The Company did not close its books for the years 1916

EXHIBIT "A" TO AGREED STATEMENT OF FACTS

(SEE INSTRUCTIONS ON PAGE 2 UNDER CORRESPONDING HEADINGS)

DETAILS OF TAXABLE INCOME (INCLUDING INCOME OF WIFE (OR HUSBAND) AND DEPENDENT CHILDREN, IF NOT REPORTED ON SEPARATE RETURNS)

WRITE "NONE" IN EACH BLOCK IN WHICH YOU HAVE NO INCOME TO REPORT

A. INCOME FROM SALARIES, WAGES, COMMISSIONS, BONUSES, DIRECTORS' FEES, AND PENSIONS, AND FROM PROFESSIONS.

1. By whom received.	2. Occupation or profession.	3. Name and address of employer or (if practicing a profession) office address.	4. Gross income.	5. Deductions, if any.	
Myself	Vice Chairman	The B.F. Goodrich Co. Akron, O	$ 50,630.00	$	
"	Directorates	Various Banks & Corporations	3,500.00		
NET INCOME FROM SALARIES, ETC. (total column 4 minus total column 5)			$ 53,880.00	$	$ 53,880.00

Explanation of deductions:

B. INCOME FROM BUSINESS (INCLUDING FARMING).

Kind of business: Business address:

GROSS SALES and income from business services $

COST OF GOODS SOLD:

Labor	$		
Materials and supplies			
Merchandise bought for sale			
Other costs			
PLUS inventories at beginning of year			
TOTAL	$		
LESS inventories at end of year			
NET COST OF GOODS SOLD	$		

OTHER BUSINESS DEDUCTIONS:

Salaries and wages not reported as "Labor" under "Cost of Goods Sold"	$		
Rent			
Interest on business indebtedness			
Taxes on business and business property			
Repairs, wear and tear, and property losses. (To be explained in table at bottom of page.)			
Bad debts arising from sales (see instructions)			
Other expenses (specify)			
TOTAL OTHER BUSINESS DEDUCTIONS	$		

NET COST OF GOODS SOLD PLUS TOTAL OTHER BUSINESS DEDUCTIONS $

NET INCOME FROM BUSINESS (INCLUDING FARMING) $

Explanations:

C. PROFITS FROM SALE OF REAL ESTATE, STOCKS, BONDS, AND OTHER PROPERTY.

1. Kind of property.	2. Year acquired.	3. Name and address of purchaser	4. Sale price	5. Original cost or market value Dec. 31, 1913

NET PROFIT FROM SALES (total of columns 4 and 7 minus total of columns 5 and 6) ..... $

Explanations: .....

D. INCOME FROM RENTS AND ROYALTIES.

1. Kind of property.	2. Name and address of tenant or lessee.	3. Amount of rent and royalties.	4. Repairs, wear and tear and property losses.	5. Interest.	6. Taxes.	7. Other expenses.
		$	$	$	$	$
TOTALS		$	$	$	$	$

NET INCOME FROM RENTS AND ROYALTIES (total of column 3 minus total of columns 4, 5, 6, and 7) ..... $

Explanations: .....

E. INTEREST ON BONDS AND OTHER OBLIGATIONS OF THE UNITED STATES ISSUED SINCE SEPTEMBER 1, 1917.

1. If not received directly state name and address of partnership or fiduciary through whom received.	2. Amount of bonds or certificates.	3. Interest received on amount in excess of $1,000.	4. Indebtedness incurred for purchase of bonds or certificates.	5. Interest paid on proportionate part of such indebtedness.	6. Excess of interest paid, if any.	7. Excess of interest received, if any.
	$	$	$	$	$	$
TOTALS [Include total of column 7 (if any) in total net income on page 4. Enter total of column 6 (if any) under 7, "Other deductions," on page 4.]		$		$	$	$

F. DIVIDENDS ON STOCK OF CORPORATIONS ORGANIZED OR OPERATING IN THE UNITED STATES AND SUBJECT TO INCOME TAX.

1. If not received directly state name of partnership or fiduciary through whom received.	2. Accumulated in 1913.	3. Accumulated in 1914.	4. Accumulated in 1915	5. Accumulated in 1916.	6. Accumulated in 1917.
	$	$	$	$ 108 071 50	$ 90 780 17
TOTALS (include total of column 6 only in total net income on page 4)	$	$	$	$	$

EXPLANATION OF REPAIRS, WEAR AND TEAR (DEPRECIATION), AND LOSSES OF BUSINESS OR RENTAL PROPERTY, AND DEPLETION OF MINES, ETC.

Refer to "A," "B," or "D," above.	3. Kind of property. (If buildings, state also material of which constructed.)	3. Year acquired.	4. Cost of buildings or other property.	5. Repairs not covered by claims for wear and tear or losses.	Wear and tear (depreciation) and depletion charged off. 6. Rate.	7. Amount previous years.	8. Amount this year.	Losses not covered by insurance. 9. Cause of loss.	10. Amount of loss.
			$	$		$	$		$

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Page 4

DETAILS OF TAXABLE INCOME (Concluded)

(SEE INSTRUCTIONS ON PAGE 2 UNDER CORRESPONDING HEADINGS)

TOTAL NET INCOME FROM SOURCES A, B, C, D, E, AND F, REPORTED ON PAGE 3 1,96,165,17

G. INTEREST ON TAX-FREE-COVENANT BONDS (on which one normal tax of 2 per cent was withheld at source).	1. Gross income.	2. Deductions, if any.	
	$	$	
NET INTEREST ON TAX-FREE-COVENANT BONDS (total column 1 minus total column 2)	$	$	$

H. OTHER INCOME (including income from partnerships and fiduciaries, except that reported under E, F, and G).	1. Gross income.	2. Deductions, if any.	
Interest on bonds and other obligations of domestic and resident corporations (except as entered under G)	$	$	$
Interest on bonds of foreign countries and corporations and dividends on stock of foreign corporations			
Interest on notes, bank deposits, mortgages (except of corporations), and all other interest	1076 76		1076 76
Income thru Partnership of the Woodward Hancock Corner Co. Detroit Mich			7 [illegible] 60
I. TOTAL NET INCOME FROM ALL SOURCES			$ 99 867 53

J. GENERAL DEDUCTIONS NOT REPORTED ON PAGE 3 OR ABOVE (EXCEPT CONTRIBUTIONS—SEE N BELOW).		
Interest on personal indebtedness	$ 70 489 87	
Taxes on dwelling and personal property, and other taxes not reported above (see instructions on page 2)	3557 13	
Other deductions, except contributions (explain). Total loss of roof on Bldg from hail storm (not covered by insurance) on Business Farm	1094 90	
TOTAL GENERAL DEDUCTIONS, EXCEPT CONTRIBUTIONS		$ 25 141 50
K. TOTAL NET INCOME (WITHOUT DEDUCTING EXCESS PROFITS TAXES OR CONTRIBUTIONS) 182,746		$ 74 725 03
L. LESS EXCESS PROFITS TAXES, IF ANY, FOR 1917 (see instructions on page 1 under "Excess profits taxes")		
M. TOTAL NET INCOME (WITHOUT DEDUCTING CONTRIBUTIONS) (K minus L)		$ 74 725 03

N. CONTRIBUTIONS TO CHARITABLE ORGANIZATIONS, ETC. (Enter below name and address of each organization and amount paid to each.)

Smith College Northampton Mass	70	00	00	$	
Hospital at Akron	7	50	00		
TOTAL (not to exceed 15 per cent of item M)					77 411 98
O. TOTAL NET INCOME ON WHICH INCOME TAX IS TO BE COMPUTED (M minus N)					$ 47 313 05

INDIVIDUAL INCOME TAX RETURN FOR CALENDAR YEAR 1917

Read all instructions. $ 2,458.60
Answer all questions. $ 1.8
If necessary, ask your Collector of Internal Revenue for assistance. LIABILITY & DUCED $

Made by (or for) (Write plainly. Give name in full.) F. H. Mason 2340477 Ohio 3/24/23

Home address 115 So Union St (Street and number or rural route) Akron (Post office and State.) Ohio

(IF NAME AND ADDRESS ARE FILLED IN AND EITHER IS INCORRECT, PLEASE CORRECT IT.)

RECEIVED — LIST — Number — Page — Line — Audited by

1. Did you make a return for 1915? Yes
2. If so, what address did you give on the return?
3. To what Collector's office was it sent? Cleveland O. (Give district or city and State.)
4. Were you on December 31, 1917, married and living with wife (or husband)? Yes
5. If not, were you head of a family as defined in instructions on page 1 under "Personal Exemption"?
6. How many dependent children under 18 (or mentally or physically incapacitated for self-support) had you on December 31, 1917?
7. If you had a family without dependent children, what was the relationship of those dependent upon you? Wife
8. Did your wife (or husband) or dependent children derive income from sources independent of you? Yes
9. If so, is such income included in this return? No
10. If not, was such income from a separate estate?
11. If a separate return has been made by (or for) wife (or husband) or dependent child, give full name and address entered at head of that return Mrs F. H. Mason 115 S Union St
12. If income of $800 or more received by wife (or husband) or dependent child is included in this return, give full name of each such person, and also address if different from that given at the head of this return
13. What address other than that previously entered on this return did you give to employers or other persons, firms, or corporations who paid you $800 or more income during 1917?
14. Is this return made from books or records kept by you in the ordinary course of business?
15. If so, were such books or records audited by a public accountant?
16. [illegible]
17. Is this return based on that accountant's report?

18. Total net income on which income tax is to be computed (item O)	$ 11	313	85		
19. Less: Excess of interest received on obligations of United States issued since Sept. 1, 1917 (item E, total of column 7)					
20. Dividends (item F, total of column 6)		90	780	17	
21. Personal exemption (see instruction 5, page 1)			2000	00	
22. Total of items 19, 20, and 21		$ 92	780	17	
23. Balance (item 18 minus item 22)		$	None		
24. Add excess of interest paid on indebtedness incurred for purchase of obligations of United States issued since Sept. 1, 1917 (item D, total of column 6)					
25. Amount subject to normal tax of 2 per cent under act of Oct. 3, 1913		$			
26. Less additional exemption			2 000	00	
27. Amount subject to normal tax of 2 per cent under act of Sept. 8, 1916		$	None		

28. Normal tax of 2 per cent on amount of item 26	$	None	
29. Additional normal tax of 2 per cent on amount of item 27			
30. Total normal tax		None	
31. Less tax withheld on tax-free covenant bonds (2 per cent of net total of Item G)			
32. Balance of normal tax due	$	745	38
33. Surtax (see table on page 2)		1	77
34. Excess profits tax at rate of 8 per cent (see instruction 7, page 1)			
35. Excess profits tax on income from business with invested capital, as computed on excess profits tax return (Form 1101)			
36. Total of items 32, 33, 34, and 35	$	1	77
37. Additional assessments and penalties (if any) 1916 Div	$		38

Deficiency — Penalty — Basis — Tax — Page — Line

I swear (or affirm) that this return, including the accompanying schedules (if any), to the best of my knowledge and belief, is a true and complete statement of all taxable gains, profits, and income received by (Enter "me" or name of person for whom return is made.) during the year 1917, and that (Enter "I am," "he is," or "she is.") entitled to all deductions and exemptions entered or claimed hereon.

(If returns made by an agent, the reason therefor must be stated on this line.)

Sworn to and subscribed before me this 27 day of March, 1918

Walter L. Means Notary Public (Signature.) (Title.)

Summit County Ohio

F. H. Mason (Signature of individual or agent.)

(Address of agent.)

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and 1917 until the end of the calendar year, as of which time for each year its books of account were made to correctly show the condition of its business and its earnings and profits for the year in question.

Horace Andrews, S. M. Jett, Attorneys for the Plaintiff. A. E. Bernsteen, Attorney for the Defendant.

(Here follows Exhibit "A" to Agreed Statement of Facts, marked side folio pages 17 & 18 and 19 & 20.)

[fol. 21] In United States District Court

Answer—Filed December 19, 1924

Now comes A. E. Bernsteen, United States Attorney for the Northern District of Ohio, and for answer to the above entitled cause of action says that he is the legal representative of C. F. Routzahn, Collector of Internal Revenue for the Eighteenth District of Ohio, the defendant aforesaid, in all matters officially arising under and regarding the cause of action alleged in the petition, and further answering admits that C. F. Routzahn is and was at all times named in the petition the Collector of Internal Revenue for the Eighteenth District of Ohio, and that plaintiff was at all times named in the petition a resident of Akron, Summit County, Ohio, in said District.

Further answering the said defendant, C. F. Routzahn, Collector of Internal Revenue for the Eighteenth District of Ohio, denies each and all of the allegations of the plaintiff's petition herein, adverse to the interest of the said defendant, or the United States of America.

Wherefore, defendant prays that said petition be dismissed and that he go hence without costs.

A. E. Bernsteen, United States Attorney.

Duly sworn to by C. F. Routzahn. Jurat omitted in printing.

[fol. 22] IN UNITED STATES DISTRICT COURT

MEMORANDUM OPINION—Filed July 2, 1925

WESTENHAVER, District Judge:

This is an action to recover back taxes paid under protest on dividends received on stock held in the B. F. Goodrich Company. Parties have waived in writing jury trial. All jurisdictional requirements have been satisfied. The evidence consists exclusively of an agreed statement of facts in writing, which is approved and adopted as my findings of fact.

Plaintiff owned and held both common and preferred stock during the years 1916 and 1917. On October 25th, 1916, the corporation declared on its common stock a dividend of $1.00 per share, payable February 15th, 1917, and another dividend on its common stock, of $1.00 per share, January 24th, 1917, payable May 15th, 1917. On October 25th, 1916, it declared a dividend of $1.75 per share on its preferred stock, payable January 2nd, 1917, and on January 24th, 1917, it declared two dividends of $1.75 per share on its preferred stock, payable one-half April 2nd, 1917, and the other half July 2nd, 1917. The dividend on the preferred stock declared October 25th, 1916, and payable January 2nd, 1917, was not included in Plaintiff's tax assessment or paid. All the other dividends were included, and the tax levied and assessed thereon at the 1917 rate. It is Plaintiff's contention that the applicable rate is that obtaining in 1916, and not the rate obtaining in 1917.

The solution of this dispute turns on the proper interpretation and construction of Section 31, added October 3rd, 1917, to the Revenue Act of 1916. This section was considered and conclusion announced in Douglas vs. Edwards (2 CCA. 298 Fed. 229). When this case was argued, it was represented that the United States Supreme Court would shortly thereafter, in April last, hear arguments in that case on review, and counsel were later advised that I would hold up the decision of the instant case until an opinion was announced by that court. It has, however, now adjourned until October, without any pronouncement having been made, and upon consideration of the interests

involved, I deem it my duty to announce my own conclusion without further delay.

If Douglas vs. Edwards is correctly decided, Defendant concedes Plaintiff is entitled to judgment. In my [fol. 23] opinion, Douglas vs. Edwards may be reversed, and Plaintiff will still be entitled to judgment. In that case the dividends in question were declared part late in September, 1917, and the remainder in December, 1917. The corporation, on declaring the dividend, announced that it was a distribution of accumulated undivided profits or surplus for the year 1916 and prior years. It appears, however, that there were ample current earnings and income accruing in the calendar year 1917, and prior to the declaration of dividends, out of which such distribution could have been made. This being so, there was presented the exact question which Defendant's counsel present to me for decision in this case, but the facts in this case have a distinctly different aspect.

Here, part of the dividends were declared in October, 1916, the remainder were declared as early as January 24th, 1917. It is true the earliest payment was February 15th, 1917, and the latest July 2nd, 1917. The corporation, on making these declarations of dividend, recited and announced that they were a distribution of accumulated and undivided profits and surplus accruing during the year 1916. It seems to me that this declaration is the only inference which may be legitimately drawn from the agreed facts.

The section in question is quoted in full in Douglas vs. Edwards. The important language is in substance this: Any distribution made to the shareholders of corporations in the year 1917 shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed for the years in which such profits or surplus were accumulated by the corporation. First, it is a distribution made by a corporadivided. Second, the distribution is from accumulated undivided profits or surplus. Third, it shall be included in the annual income of the shareholder for the year in which

received. And fourth, it shall be taxed to the distributee, not at the rates prescribed for the year in which received by the distributee, but at the rates prescribed for the years in which such profits or surplus were accumulated. "Earnings or profits," as is pointed out in Douglas vs. Edwards, appears six times in the same Act, whereas "most recently accumulated undivided profits or surplus" appears only in the connection above stated. The difference in language [fol. 24] is so distinct as to evidence a difference in meaning. This however, is not the strongest consideration. Section 31 distinguishes between the year in which the shareholder receives payment of the income and the year in which the corporation shall have accumulated undivided profits or surplus. The shareholder is to include it as a part of his annual income for the year in which it is received. It is to be taxed, however, at the rate prevailing during the year in which it was accumulated. Obviously, therefore, a distinction is made not only between earnings or profits and accumulated undivided profit or surplus, but also between distribution by the corporation and receipt of the sum distributed, by the shareholder. As applied to the facts of the instant case, this last consideration seems to be controlling.

A distribution by the corporation to the shareholders takes place when the declaration of the dividend is made, and not when the dividend is paid. The amount of the dividend, after the declaration, becomes the property of the shareholder. As between him and the corporation, the relation of debtor and creditor as to such dividend is at once created. If, after the declaration and before the payment, the shareholder dies or sells his shares, the dividends, in the absence of any stock report board rule or by-law to the contrary, passes to the executor or the purchaser. It is, in substance, a debt due from the corporation, payable in the future at the date specified. These principles are well settled and have been applied to dividends declared under the Income Tax Act of October 3rd, 1913, making the effective date of distribution the date the dividend was declared, and not the date when it was paid. See United States vs. Guinzburg (2 C. C. A.) 278 Fed. 363; Plant vs. Walsh (D. C.) 280 Fed. 722. In addition thereto,

it is familiar law that a corporation cannot lawfully declare a dividend except from accumulated undivided profits or surplus in existence at the time such declaration is made. It is customary, if not essential, that the existence thereof shall have been ascertained by some form of profit and loss statement. This profit and loss statement should show, carried into the surplus or undivided profits, the earnings previously made.

All of these principles must have been within the knowledge and cognizances of the law makers when they phrased Section 31. It is not necessary to go the length of Doug-[fol. 25] las vs. Edwards in construing the language "accumulated undivided profits or surplus," but it is essential that the undivided profits or surplus should at least have been susceptible of ascertainment, and of being carried into a profit and loss statement, if one had been made. Upon the facts agreed, no undivided profits or surplus had or could be accumulated in this sense, even if some had been earned after January 1st, 1917, and prior to January 24th, 1917. According to the law, and the customary principles of corporate management, the dividend declaration of January 24th must have been made on the basis of a profit and loss statement closed not later than the first of that month. If, therefore, distribution by the corporation, within the contemplation of Section 31, means the declaratory distribution made by the corporation, as distinguished from the receipt of the dividend when actually paid, by the shoreholder, it follows that the dividends now in controversy must be a distribution of accumulated undivided profits or surplus for 1916.

I am content to dispose of this case on this ground: I agree that the word "deemed" is to be taken in the sense of "conclusively presumed." If there are or have been accumulated undivided profits or surplus before the distribution is declared or, in other words, made, it will be conclusively presumed against the shareholder that the distribution is from those most recently accumulated; but it is essential that the existence of accumulated undivided profits or surplus should be shown. In this case the showing is to the contrary, and it is not necessary, in order to support this showing, that a finding should be made upon the question of law and fact propounded in the last paragraph

of the agreed statement of facts. It may be, as is contended by Defendant, the tire sales under the facts agreed were what in law is known as a sale or return, and not a bailment, or a consignment. Even so, the showing is conclusive that on January 24th, 1917, when the last dividend was declared i. e., when the last distribution was made, there could not have been in existence accumulated undivided profits for any period later than the year 1916.

Due consideration has been given to the conflicting decisions of Douglas vs. Edwards (D. C.) 287 Fed., reversed by the Second Circuit Court of Appeals; Harder vs. Irwin (D. C.) 285 Fed. 402. In the main, I agree with the reasoning of the Second Circuit in reversing those decisions. In [fol. 26] my opinion, the District Courts above ignore the well settled rule that in statutes levying taxes, all doubts inhering therein must be resolved against the Government and in favor of the taxpayer. United States vs. Merriam, 263 U. S. 179; Gould vs. Gould, 245 U. S. 151.

Judgment will be rendered for Plaintiff for amount prayed in the petition.

D. C. Westenhaver, Judge.

July 2, 1925.

In United States District Court

Judgment—Entered September 18, 1925, by D. C. Westenhaver, Judge

This cause came on for trial before the Honorable D. C. Westenhaver, District Judge, the parties having duly stipulated that said case should be tried before the Court without a jury, and was submitted upon the pleadings and on an agreed statement of facts stipulated between the parties and filed herein; and the Court, being fully advised in the premises, do find the issues in this case in favor of the plaintiff, and that the plaintiff is entitled to have and recover of and from the defendant the sum of Twelve Thousand Four Hundred Fifty-eight and 60/100 Dollars ($12,458.60), with interest thereon at six per cent. (6%) per annum, from May 12, 1923, together with the costs and disbursements of this action.

Now, Therefore, it is ordered and adjudged that the plaintiff recover from the defendant the sum of Twelve Thousand Four Hundred Fifty-eight and 60/100 Dollars ($12,458.60), with interest thereon at six per cent. (6%) per annum from May 11, 1923, to the date of entry of this judgment, amounting in all to the total sum of Fourteen Thousand Two Hundred Two and 72/100 Dollars ($14,202.72), together with his costs and disbursements herein.

[fol. 27] IN UNITED STATES DISTRICT COURT

PETITION FOR WRIT OF ERROR—Filed December 8, 1925

To the Honorable D. C. Westenhaver, Judge of the District Court aforesaid:

Now comes A. E. Bernsteen, United States Attorney for the Northern District of Ohio, Eastern Division, representative of C. F. Routzahn, Collector of Internal Revenue for the Eighteenth Internal Revenue District of Ohio, and respectfully shows that on the 18th day of September, A. D. 1925, the above-named District Court entered a judgment herein in favor of the plaintiff and against the defendant to the prejudice of the defendant.

The defendant herewith petitions the Court for an order allowing it to prosecute a writ of error to the Circuit Court of Appeals of the United States, for the Sixth Circuit, under the laws of the United States in such cases made and provided.

Wherefore, premises considered your petitioner prays that a writ of error do issue, that an appeal in this behalf to the United States Circuit Court of Appeals aforesaid, sitting at Cincinnati, Ohio, in said Circuit for the correction of the errors complained of and herein assigned, be allowed and that all further proceedings may be suspended until the determination of said writ of error by the Circuit Court of Appeals.

A. E. Bernsteen, Attorney for Petitioner.

IN UNITED STATES DISTRICT COURT

ASSIGNMENTS OF ERROR—Filed December 8, 1925

Comes now the defendant in the above-entitled cause, Carl F. Routzahn, as Collector of Internal Revenue for the Eighteenth District of Ohio, and presents to the Court his assignments of error which he alleges were committed in the trial and procedings in the above cause to his prejudice and injury as follows:

[fol. 28] 1. The court erred in holding that dividends received by the plaintiff during the year 1917 from the B. F. Goodrich Company, after that paid to him on January 2, 1917, should be taxed for Federal income taxes at the rates prescribed for the year 1916.

2. The court erred in not holding that the phrase "most recently accumulated undivided profits or surplus," as used in subdivision (b) of section 31 of the Revenue Act of October 3, 1917, included current earnings of the B. F. Goodrich Company during the year 1917, and that the dividends received by the plaintiff during the year 1917, subsequent to that received by him on January 2, 1917, were paid out of undivided profits or surplus of the year 1917 and were taxable for Federal income taxes at the rates prescribed for the year 1917.

3. That the finding is not sustained by law.

4. The court erred in giving judgment for the plaintiff.

5. The court erred in not giving judgment for the defendant.

A. E. Bernsteen, United States Attorney.

IN UNITED STATES DISTRICT COURT

ORDER ALLOWING WRIT OF ERROR—Entered December 8, 1925, by Paul Jones, Judge

This day came the defendant, by A. E. Bernsteen, United States Attorney for the Northern District of Ohio, and filed herein and presented to the Court its assignment of errors

and petition for allowance of writ of error intended to be urged by it, praying also that a transcript of the record, proceedings and papers upon which the judgment herein was rendered, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Sixth Circuit, and such other and further proceedings may be had as may be proper in the premises.

On consideration whereof, the Court does allow the writ of error.

[fol. 29] IN UNITED STATES DISTRICT COURT

WRIT OF ERROR—Filed December 8, 1925

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

UNITED STATES OF AMERICA,
Sixth Judicial Circuit, ss:

The President of the United States to the Honorable the Judge of the District Court of the United States for the Northern District of Ohio, Greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, or some of you, between F. H. Mason, as plaintiff, and C. F. Routzahn, Collector of Internal Revenue for the Eighteenth District of Ohio, as defendant, a manifest error hath happened, to the great damage of said C. F. Routzahn, Collector of Internal Revenue for the Eighteenth District of Ohio, as by his complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if the judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Sixth Circuit, together with this writ, so that you have the same at Cincinnati, in said Circuit, on the* 7th day of January

*Not exceeding 30 days from the day of signing the citation.

next, in the said Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States should be done.

Witness the Honorable William Howard Taft, Chief Justice of the United States, the 8th day of December, in the year of our Lord one thousand nine hundred and twenty-five, and of the Independence of the United States of America the one hundred and fiftieth.

B. C. Miller, Clerk of the District Court of the United States for the Northern District of Ohio, by F. J. Denzler, Deputy Clerk. (Seal.)

[fol. 30] Allowed by Paul Jones, Judge of the District Court.

Return to writ of error omitted in printing.

[fols. 31 & 32] Citation, in usual form, showing service on Horace Andrews, omitted in printing.

[fol. 33] In United States District Court

Order Extending Time—Entered December 30, 1925, by Paul Jones, Judge

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to February 6, 1926.

IN UNITED STATES DISTRICT COURT

ORDER EXTENDING TIME—Entered February 6, 1926, by Paul Jones, Judge

On application of defendant and for good cause shown, it is ordered that the time for filing the transcript of record in the United States Circuit Court of Appeals be extended to March 8, 1926.

[fol. 34] IN UNITED STATES DISTRICT COURT

PRECIPE FOR TRANSCRIPT OF RECORD—Filed December 8, 1925

To the Clerk:

Please prepare transcript of record for the Circuit Court of Appeals in the above entitled cause and include therein the following papers, orders and documents:

Petition.
Summons.
Answer.
Agreed Statement of Facts.
Memorandum opinion of Court.
Judgment.
Petition for Writ of Error.
Assignment of Errors.
Allowance of Writ of Error.
Writ of Error.
Return on Writ of Error.
Citation in Error.
Precipe.
Orders extending time for filing transcript of record.

And deliver all papers to The Gates Legal Publishing Company for printing.

A. E. Bernsteen, Attorney for Defendant.

[fols. 35 & 36] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 37] In the United States Circuit Court of Appeals for the Sixth Circuit

Argument and Submission

(June 11, 1926—Before Denison, Donahue, and Moorman, JJ.)

This cause is argued by Mr. Charles T. Hendler, Special Attorney, Bureau of Internal Revenue, for the Plaintiff in Error, and by Mr. Horace Andrews, for the Defendant in Error, and is submitted to the Court.

In United States Circuit Court of Appeals

Error to the District Court of the United States for the Northern District of Ohio

Judgment—Filed June 30, 1926

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Ohio, and was argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be and the same is hereby reversed and the cause remanded with directions to enter judgment for defendant.

[fol. 38] In United States Circuit Court of Appeals

Before Dension, Donahue, and Moorman, Circuit Judges

Opinion—Filed July 10, 1926

Per Curiam:

Since this case was decided below, the Supreme Court's opinion in Edwards v. Douglas has appeared—(269 U. S. 204). While upon its facts the present case can be distinguished from that one, yet we conclude that the general view of the purpose and construction of the law there stated

by Mr. Justice Brandeis must be applied here; and this leads us to a reversal of the judgment below.

The corporate dividends which came to Mason and formed the basis of this tax, were declared near the end of 1916 and were made payable and were paid at various dates in 1917, from February until July. They are returned by Mason as a part of his 1917 income; and the question is whether the 1916 or 1917 taxing rates should be applied. The statute (Sec. 31 b, Revenue Act of October 3, 1917) for the purpose of attaching the taxing rate to dividends, imperatively specifies that "any distribution made by a corporation to its shareholders * * * shall be deemed to have been made from the most recently accumulated undivided profits or surplus." The court below concluded that the "distribution" was made when the dividend was declared, segregated from the body of undivided profits and became a debt from the company to the stockholder which he could sell independently of the stock. That, as between the stockholder and the corporation and from many points of view, such a declaration is a distribution of profits, is indisputable; but this is a taxing statute, the dominant thought of which is that the citizen should suffer an annual burden upon his annual current income. "Distribution" must mean a disposition which at that moment results in income; because to ascertain taxable income is the purpose and subject matter of the act, and a dividend declared this year, payable in the next or some more distant year, is not within the normal conception of income for this year. Though the legal duty to pay is fixed [fol. 39] by such a declaration, it is commonly recognized that actual and prompt payment is contingent upon the continuance of expected conditions. Books might be kept upon an accrual basis, so as to show such items as becoming income upon declaration, but they would have to be discounted to their present worth, and this can hardly be the normal method of treatment which Congress should be deemed to have had in mind. Indeed, it appears that Mason did not treat these items as part of his 1916 income, and his conduct serves to indicate that he did not understand when he made his return for 1916, that any income had been distributed to him during that year by this declaration. Upon the whole we are satisfied that, in

the environment of this statute, "distribution made" means "dividends paid."

This brings us to the phrase "most recently accumulated" profits. This may refer to any one of three kinds of profits. First, those which at the time of the dividend payment have been formally recognized and entered on the books as profits for a fixed period, and are normally destined to be paid out in dividends; second, those which in fact have then come into existence but have not been ascertained or stated on the books; third, those which are finally ascertained and entered as the profits for the entire year during which dividends are paid. The first construction must be rejected on the authority of Edwards v. Douglas. The second is logically permissible, but is impracticable. Not only may profits seeming to exist in July disappear before the end of the year, but it is often, if not typically, humanly impossible to determine with any accuracy in what months of the year the profits were made. To attempt to administer the law upon this theory would bring endless and hopeless confusion and disputes. A meaning which would inevitably make the law most difficult of application and in large degree unworkable ought not unnecessarily to be attributed to Congress.

The third construction can not be spelled out in the very words of the law; but if the entire taxing year should be taken as a unit, as Justice Brandeis says should be done (probably as applied here meaning 1917), it is seen that when the return was made in March, 1918, the tax payer [fol. 40] knew that profits had been accumulated in 1917 from which all 1917 dividends could be paid; and it is not unreasonable to suppose that the "most recently accumulated profits" are to be judged from the end of the fiscal year during which the income was received. We see no other construction which will furnish a common yardstick by which the tax can be measured in all cases; and we conclude that the principle on which Edwards v. Douglas was decided requires us to adopt this third construction.

It results that the judgment below must be reversed. Upon this record there should have been a judgment for defendant; and since the rule of the Slocum Case, 228 U. S. 364, depends upon the right to a jury trial, and in the present case a jury was waived and the facts agreed upon,

we can, and do, now direct that judgment to be entered by the District Court.

IN UNITED STATES CIRCUIT COURT OF APPEALS

MOTION TO STAY MANDATE—Filed July 21, 1926

Now comes the defendant in error, F. H. Mason, and represents to the Court that steps are being taken to file a petition in the Supreme Court of the United States for a writ of certiorari to review the judgment of this Court in the above entitled action.

The defendant in error therefore prays that this court will by its order stay the sending down of its mandate to the District Court for the Northern District of Ohio, Eastern Division.

Horace Andrews, Counsel for F. H. Mason, Defendant in Error.

[fols. 41-56] Petition for rehearing and brief in support thereof, covering 15 pages, filed August 7, 1926, omitted from this print. It was denied and nothing more by order October 7, 1926.

[fol. 57] IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER STAYING MANDATE—Filed October 7, 1926

Ordered, that motion to stay mandate herein pending application to the Supreme Court for writ of certiorari, is hereby granted subject to the following condition; the applicant shall within thirty days from the date of this order file petition for the writ in the Supreme Court, give the notice to opposing counsel required by Supreme Court Rule 35 and file in this court proof of such filing and notice. Unless this condition is complied with, the mandate herein will issue either upon the court's own motion and without notice, or upon motion of opposing party upon notice, as to the court may seem best; but in the event of such compliance the mandate will be stayed until final action in the case is taken by the Supreme Court.

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER DENYING PETITION FOR REHEARING—Filed October 7, 1926

The petition for rehearing of this cause is hereby denied.

[fol. 58] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 59] IN SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed January 17, 1927.

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

No. .....

In the Supreme Court of the United States

F. H. Mason,
Petitioner,

vs.

C. F. Routzahn, Collector of
Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI
and
BRIEF IN SUPPORT OF PETITION.

S. M. Jett,
Horace Andrews,
Attorneys for Petitioner.

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No. .....

In the Supreme Court of the United States

F. H. MASON,
Petitioner,

vs.

C. F. ROUTZAHN, Collector of
Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable The Supreme Court of the United States:

Your petitioner respectfully shows to this Court as follows:

A.

SUMMARY OF FACTS.

1. Your petitioner was, at the time of the commencement of this suit, and still is, a citizen and resident of the State of Ohio, and the respondent was and still is the Collector of Internal Revenue for the Eighteenth District of Ohio.

2. This is a petition for writ of certiorari to review the final determination of the Circuit Court of Appeals for the Sixth Circuit, made and entered on June 30, 1926, and a petition for rehearing overruled on October 7, 1926, reversing the judgment theretofore entered in the District Court of the United States for the Northern District of Ohio, Eastern Division, in which the petitioner was plaintiff and the respondent was defendant. A certified copy of the entire transcript of the record in the case, including the proceedings in the Circuit Court of Appeals and opinion of that Court, is furnished and filed herewith.

3. This case involves the construction of Section 31 (b) of the Revenue Act of 1917, which is as follows:

> "(b) Any distribution made to the shareholders or members of a corporation, join-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, etc."

This suit was begun to recover the sum of $12,458.60 of income taxes wrongfully exacted on corporate dividends received during the year 1917. Mason's return computed the tax at the 1916 rate,—because the dividend distributions in question were actually made from the 1916 surpluses of the Company. When the dividends in question were declared, and until after all of them had been paid, the corporation had no undivided profits or surplus for 1917. Nevertheless, the Department assessed the tax at the 1917 rate.

The District Court held that under Section 31 (b) of the 1917 law, the 1916 tax rate was applicable under the agreed facts. Judgment was entered in favor of Mason for the amount claimed with interest.

The decision of the Circuit Court of Appeals, reversing the judgment of the District Court, resulted from a misapprehension of the decision of this Court in *Edwards vs. Douglas*, 269 U. S. 204, based upon a single paragraph found in that opinion. As a result, the Circuit Court of Appeals misconstrued and misapplied Section 31 (b) of the Act of 1917.

STOCK OWNERSHIP AND DIVIDEND DISTRIBUTIONS.

4. Your petitioner owned and held prior to and during the years 1916 and 1917 shares of common stock and preferred stock of The B. F. Goodrich Company, a New York corporation, doing business in Ohio. Prior to January 1, 1917, this Company had accumulated in its treasury a large surplus arising out of its business, more than sufficient to pay all the dividends hereinafter referred to.

5. Dividends were declared and paid by The B. F. Goodrich Company to its common stockholders at $1.00 per share for each dividend, and to its preferred stockholders at $1.75 per share for each dividend, as follows, to-wit:

COMMON STOCK.

Date of Declaration	*Date of Payment*	*Received by Mason*
October 25th, 1916	February 15th, 1917	$22,781.00
January 24th, 1917	May 15th, 1917	22,781.00

PREFERRED STOCK.

Date of Declaration	*Date of Payment*	*Received by Mason*
October 25th, 1916	January 2nd, 1917	$17,517.50
January 24th, 1917	April 2nd, 1917	17,473.75
January 24th, 1917	July 2nd, 1917	17,473.75

(R. p. 3).

6. It is evident from the facts in the record, and was found by the District Court, that when these *dividends were declared* The B. F. Goodrich Company had no undivided profits or surplus for the year 1917. The District Court found it unnecessary to determine as to the earnings or profits of the Goodrich Company between January 24th and July 2, 1917, yet the record abundantly shows that the Company had no profits for the year 1917 until after all of the dividends here in question had been paid.

On January 28th, 1918, the Company sent notice to F. H. Mason, and to all its other stockholders, that—

> "The dividends on the preferred stock of this company which were paid on January 2nd, 1917, April 2nd, 1917, and July 2nd, 1917, and on the common stock which were paid on February 15th, 1917 and May 15th, 1917,—were declared from the net profits accumulated in the calendar year 1916, which were the most recently accumulated undivided profits of the company." (R. p. 13).

7. In his return for the year 1917, Mason reported the dividends here in question as paid from the surplus and profits of the Company for the year 1916; and paid the tax based upon that part of his income at the 1916 rates (R. p. 13).

The Treasury Department determined that Mason was not entitled to pay taxes upon dividends from the Goodrich Company during 1917, at the 1916 rates, but should be taxed thereon at the 1917 rates (R. pp. 13 and 14), and the Commissioner assessed additional taxes. On demand of the Collector, with threat of distraint (R. pp. 14 and 15) Mason paid such additional tax under protest, made claim for refund, which was rejected, and thereupon this suit was begun.

The case went to trial in the District Court and was decided on July 2, 1925 (R. pp. 22-26) (8 Fed. Rep. 2nd Series, page 56).

OPINION OF DISTRICT COURT.

8. In the opinion of the District Court, the following appears:

> "The solution of this dispute turns upon the proper interpretation and construction of Section 31, added October 3, 1917, to the Revenue Act of 1916 (R. p. 22)."

The Court in comparing the facts of this case with those in the case of *Douglas vs. Edwards* (R. p. 23) pointed out that in that case there were ample earnings for the year 1917 prior to the date of declaration out of which the distributions in question in that case could have been made, and then proceeded:

> "Here, part of the dividends were declared in October, 1916, the remainder were declared as early as January 24th, 1917. It is true the earliest payment was February 15th, 1917, and the latest July 2nd, 1917. The corporation, on making these declarations of dividend, recited and announced that they were a distribution of accumulated and undivided profits and surplus accruing during the year 1916. *It seems to me that this declaration is the only inference which may be legitimately drawn from the agreed facts.*" (Italics ours.)

The Court also said (R. p. 24):

> "A distribution by the corporation to the shareholders takes place when the declaration of the dividend is made, and not when the dividend is paid. The amount of the dividend, after the declaration, becomes the property of the shareholder. As between him and the corporation, the relation of debtor and creditor as to such dividend is at once created. If, after the declaration and before the payment, the shareholder dies or sells his shares, the dividend, in the absence of any stock report board rule or by-law to the contrary, passes to the executor or the purchaser. It is, in substance, a debt due from the corporation, payable in the future at the date specified. These principles are well settled and have been applied to dividends declared under the Income Tax Act of October 3rd, 1913, making the effective date of distribution the date the dividend was declared, and not the date when it was paid. See *United States vs. Guinzburg*, (2 C. C. A.) 278 Fed. 363; *Plant vs. Walsh*, (D. C.) 280 Fed. 722. In addition thereto, it is familiar law that a corpora-

tion cannot lawfully declare a dividend except from accumulated undivided profits or surplus in existence at the time such declaration is made * * *.

"All of these principles must have been within the knowledge and cognizance of the law makers when they phrased Section 31."

The Court further said (R. p. 25):

"I am content to dispose of this case on this ground: I agree that the word 'deemed' is to be taken in the sense of 'conclusively presumed.' If there are or have been accumulated undivided profits or surplus before the distribution is declared or, in other words, made, it will be conclusively presumed against the shareholder that the distribution is from those most recently accumulated; but it is essential that the existence of accumulated undivided profits or surplus should be shown. In this case the showing is to the contrary, and it is not necessary, in order to support this showing, that a finding should be made upon the question of law and fact propounded in the last paragraph of the agreed statement of facts. It may be, as is contended by defendant, the tire sales under the facts agreed were what in law is known as a sale or return, and not a bailment, or a consignment. *Even so, the showing is conclusive that on January 24, 1917, when the last dividend was declared, i. e., when the last distribution was made, there could not have been in existence accumulated undivided profits for any period later than the year 1916.*" (Italics ours.)

Judgment was rendered for the plaintiff for the amount prayed in the petition.

DECISION OF THE CIRCUIT COURT OF APPEALS.

9. This case was thereupon removed on writ of error to the Circuit Court of Appeals for the Sixth Circuit, and the judgment of the District Court was reversed (R. pp. 38-40) (13 Fed. Rep. 2d Series, page 702).

The Circuit Court of Appeals said (R. p. 38):

"Since this case was decided below, the Supreme Court's opinion in *Edwards vs. Douglas* has appeared, 269 U. S. 204. While upon its facts the present case can be distinguished from that one, yet we conclude that the general view of the purpose and construction of the law there stated by Mr. Justice Brandeis must be applied here, and this leads us to a reversal of the judgment below."

The Court also said:

"The court below concluded that the 'distribution' was made when the dividend was declared, segregated from the body of undivided profits, and became a debt from the company to the stockholder, which he could sell independently of the stock.

"That, as between the stockholder and the corporation and from many points of view, such a declaration is a distribution of profits, is indisputable, but this is a taxing statute, the dominant thought of which is that the citizen should suffer an annual burden upon his annual current income."

The Court then held that the declaration of a dividend does not constitute a "distribution" by a corporation within the meaning of Section 31 (b) of the Act and said:

"This brings us to the phrase 'most recently accumulated' profits. This may refer to any one of three kinds of profits. First, those which at the time of the dividend payment have been formally recognized and entered on the books as profits for a fixed period, and are normally destined to be paid out in dividends; second, those which in fact have then come into existence but have not been ascertained or stated on the books; third, those which are finally ascertained and entered as the profits for the entire year during which dividends are paid. The *first* construction must be rejected on the authority of *Edwards vs. Douglas.*

"The *second* is logically permissible, but is impracticable. Not only may profits seeming to exist in

July disappear before the end of the year, but it is often, if not typically, humanly impossible to determine with any accuracy in what months of the year the profits were made. To attempt to administer the law upon this theory would bring endless and hopeless confusion and disputes. A meaning which would inevitably make the law most difficult of application and in large degree unworkable ought not unnecessarily to be attributed to Congress.

"The *third* construction *can not be spelled out in the very words of the law;* but if the entire taxing year should be taken as a unit, as Justice Brandeis says should be done (probably as applied here meaning 1917) it is seen that when the return was made in March, 1918, the taxpayer knew that profits had been accumulated in 1917 from which all 1917 dividends could be paid; and it is not unreasonable to suppose that the 'most recently accumulated profits' are to be *judged from the end of the fiscal year* during which the income was received. We see no other construction which will furnish a common yardstick by which the tax can be measured in all cases; and we conclude that the principle on which *Edwards vs. Douglas* was decided requires us to adopt this third construction." (Italics ours.)

The judgment below was thereupon reversed, and the Court directed that judgment be entered in the District Court in favor of Routzahn, the plaintiff in error.

Thereafter, a petition for rehearing was filed (R. p. 41) but was denied (R. p. 57).

10. The decision of the Circuit Court of Appeals is erroneous in two important respects, in each of which it is contrary to principle and in conflict with the decisions of this Court and of all other courts:

1. It held that the *declaration of a dividend* does not constitute a "distribution" by a corporation within the meaning of Section 31 (b) of the 1917 Act.

This holding is in direct conflict with the decisions of other Circuit Courts of Appeals and Federal Courts, and with the decisions of the Board of Tax Appeals. *United States vs. Guinzburg,* 278 Fed. 366 (2d Circuit Court of Appeals): *Plant vs. Walsh,* 280 Fed. 722 (D. C.); *Mason vs. Routzahn,* 8th Fed. 2d, 56 (D. C.); *Phillips vs. United States,* 12 Fed. 2d, 598 (D. C.) (This case now pending for decision in the Third Circuit Court of Appeals); *Appeal of A. H. Stange,* 1 B. T. A. 810; *Appeal of Mary A. Fitzgerald,* Doc. No. 810 (Decided October 26, 1926) Commerce Clearing House (1926 B. T. A. Service), Vol. 3, page 3389; *Appeal of Maurice J. Curran,* Doc. No. 793 (Decided Oct. 26, 1926) Commerce Clearing House (1926 B. T. A. Service), Vol. 3, page 3399.

It is also in conflict with the general law which must have been in contemplation of Congress in adopting the Act. *Wheeler vs. Northwestern Sleigh Co.,* 39 Fed. 347; *Staats vs. Biograph Co.,* 236 Fed. 456, 458, especially the decisions of the courts of New York where the Goodrich Company was incorporated,—*Hopper vs. Sage,* 112 N. Y. 530; *Matter of Kernochan,* 104 N. Y. 618; *Brundage vs. Brundage,* 60 N. Y. 544; *Boardman vs. Railway Co.,* 84 N. Y. 178.

2. It adopted a construction of Section 31 (b) of the Act, which it stated "cannot be spelled out in the very words of the law"; and held that for the purpose of determining from what year's profits dividend distributions are deemed to have been made, the "most recently accumulated profits," as used in Section 31 (b), did not mean those of the current year which in fact had come into existence before or at the time of the dividend distribution; but that within the meaning of the law, the "most recently accumulated profits" are those which are *finally ascertained and entered* as the profits for the "entire year during which

dividends are paid," and are to be "judged from the end of the fiscal year during which the income was received," even though up to the time of the dividend distributions, there were no profits for that year.

This holding and determination is:

(a) In direct conflict with the decisions of this Court, that a tax law cannot be extended beyond the express words of the law, and that in case of doubt such a law must be construed against the Government and in favor of the taxpayer. *United States vs. Merriam,* 263 U. S. 179, 187-188; *Eidman vs. Martinez,* 184 U. S. 578, 583.

(b) In conflict with the express language, intention and meaning of Section 31 (b); and in conflict with the regulations of the Treasury Department under which most other taxpayers have been taxed.

(c) It also misapplies, misconstrues and is therefore in conflict with the decision of this Court in *Edwards vs. Douglas,* 269 U. S. 204, which held that "most recently accumulated profits" from which distributions are deemed to have been made, are not required to be those ascertained and entered in book accounts at the end of the year, but include current earnings.

11. Various cases are now pending in other Federal Courts awaiting the final determination by this Court of the questions here involved—so that until finally and definitely settled, like cases will be brought to the attention of the courts in various sections of this country, involving continued litigation.

From the foregoing, it is plain that this case involves questions as to which the decisions of the Federal Courts are in direct conflict. It also involves important questions affecting the public generally, by reason of which the questions here presented should be promptly determined by this

Court, to the end that the construction of Section 31 (b) and the rights thereunder of taxpayers be finally determined, so that a great amount of litigation and waste of time of the courts will be avoided.

WHEREFORE, your petitioner respectfully represents that the case is one of gravity, importance, and of general public interest, and your petitioner prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Sixth Circuit, commanding said Court to certify and send to this Court on the date to be designated in said writ, full and complete certified transcript of the record of all proceedings in said Circuit Court of Appeals in this case, to the end that said case may be reviewed and determined by this Court, as provided by law, and that your petitioner may have such other and further relief and remedy in the premises as to this Court may seem proper.

F. H. MASON,
By S. M. JETT,
Of Counsel.

S. M. JETT,
HORACE ANDREWS,
Counsel for Petitioner.

STATE OF OHIO,
SUMMIT COUNTY, SS.

F. H. MASON, being first duly sworn says that he has read the foregoing petition and knows the contents thereof, and that the facts therein stated are true to the best of his knowledge, information and belief.

F. H. MASON.

Sworn to and subscribed before me this 13th day of December, A. D. 1926.

.....

Notary Public.

My commission expires .....

I hereby certify that I have examined the foregoing petition, and in my opinion the petition is well founded, and that the case is one in which the prayer of the petitioner should be granted by this Court.

S. M. JETT.

No. .....

In the Supreme Court of the United States

F. H. Mason,
Petitioner,

vs.

C. F. Routzahn, Collector of Internal Revenue,
Respondent.

BRIEF

In Support of Petition for Writ of Certiorari.

The judgment of the Circuit Court of Appeals is reported in 13 Fed. 2d Edition, page 702. Said judgment was filed on June 30, 1926 (R. p. 37); application for rehearing was filed August 7, 1926 (R. p. 41); order overruling the petition was filed October 7, 1926 (R. p. 57).

The questions considered in this brief relate to the decision of the Circuit Court of Appeals for the Sixth Circuit, in matters of general public importance relative to the construction of the Income Tax Law of 1917, affecting the rights of all taxpayers and the determination of many pending cases. It is in conflict with the terms of the law of 1917, and with the regulations and rulings of the Department, and is also in conflict with the decisions of other circuit courts of appeals, and of this Court, and with the weight of authority.

1. It held that while, between the corporation and its stockholders, the declaration of a dividend constitutes a "distribution" by the corporation, yet for tax purposes it does not constitute a "distribution" within the meaning of Section 31 (b) of the Act of 1917.

2. Said decision gives a construction to Section 31 (b) of the Act, which it states "cannot be spelled out in the very words of the law."

3. It held that dividend distributions declared in October, 1916, and January, 1917, which were actually paid in the months from January to July 2, 1917, when there were no profits of the Company actually in existence later than those of the year 1916, were nevertheless, deemed to have been made from 1917 profits which were earned in the latter part of the year 1917.

4. It held that within the meaning of said Section 31 (b) providing:

> "Any distribution made to the shareholders * * * of a corporation, * * * in the year 1917, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus,"

the "most recently accumulated profits" within the meaning of said section are those which "are *finally ascertained and entered* as profits for the entire year during which dividends are paid," and are to be "judged from the end of the fiscal year during which income was received."

ARGUMENT.

I.

THE HOLDING OF THE CIRCUIT COURT OF APPEALS THAT THE DECLARATION OF A DIVIDEND BY A CORPORATION DOES NOT CONSTITUTE A "DISTRIBUTION" WITHIN THE MEANING OF SECTION 31 (b) OF THE ACT OF 1917 IS CONTRARY TO THE HOLDING OF ALL OTHER COURTS AND TRIBUNALS.

Section 31 (b) in express terms, refers to "*any distribution* made to the shareholders * * * of a corporation * * *." This language is sweeping and without qualification.

That the declaration of a dividend by a corporation irrevocably creates an indebtedness from the company to its stockholders, is universally held by courts and text writers. Such indebtedness is severed from the shares of stock and may be sold or assigned, separated therefrom, from the time of the declaration forward.

Wheeler vs. Northwestern Sleigh Company, 39 Fed. 347, *Hopper vs. Sage,* 112 N. Y. 530, *In Matter of Kernochan,* 104 N. Y. 618, *Brundage vs. Brundage,* 60 N. Y. 544, *Boardman vs. Railway Company,* 84 N. Y. 178, *Staats vs. Biograph Co.,* 236 Fed. 456.

The Circuit Court of Appeals in its decision concedes that the declaration of a dividend does constitute a "distribution" from the corporation to the stockholder, and for other purposes. There is nothing in Section 31 (b) which narrows or limits the meaning of *"any distribution."*

That the declaration of a dividend constitutes a distribution to the stockholders within the federal tax laws, and within the provisions of Section 31 (b) of the Act of 1917, has been held by every other court or tribunal which has considered this question under Section 31 (b) down to the present time.

In *United States vs. Guinzburg,* 278 Fed. 366, the Second Circuit Court of Appeals dealt with a case where a dividend had been declared before March 1, 1913, but paid after that date. The Court in a learned opinion set forth the principles hereinbefore stated and held that the amount of the dividend became capital of the stockholder upon its declaration, and therefore, the stockholder was not subject to taxation under the Act of 1913, because he received payment after March 1, 1913.

In *Plant vs. Walsh,* 280 Fed. 722, the District Court decided the same proposition, following the holding in *United States vs. Guinzburg.*

In *Phillips vs. United States,* 12 Fed. 2nd, 598 (now pending in the 3rd Circuit Court of Appeals) the District Court held that the declaration of dividends constitutes a distribution under the Section 31 (b) of the Act of 1917.

In the *Appeal of A. H. Stange,* 1 B. T. A. 810, the Board of Tax Appeals in an exhaustive opinion, held that the declaration of a dividend constituted a distribution within the meaning of Section 31 (b). The Board of Tax Appeals has also recently decided at least three other cases, namely the *Appeal of Harmon W. Hendricks,* (Sept. 30, 1926) 4 B. T. A. Service 3259, Commerce Clearing House, 1926 B. T. A. Service Vol 3 page 3259; *Appeal of Mary A. Fitzgerald* (Oct. 26, 1926) Commerce Clearing House, 1926 B. T. A. Service Vol. 3 page 3389); *Appeal of Maurice J. Curran,* (Oct. 26, 1926) Commerce Clearing House, 1926 B. T. A. Service Vol. 3 page 3399;—in each of which cases, the Board of Tax Appeals held that the declaration of a dividend by a corporation constituted a distribution within the meaning of Section 31 (b) of the Act of 1917.

Thus it is sufficiently evident that the decision of the Circuit Court of Appeals in this case is in conflict with all the other holdings relative to this important question; and that it has created an uncertainty as to what constitutes a "distribution" within the meaning of Section 31 (b) of the 1917 Act.

The many cases which are now pending involving this question will come on for hearing in various courts, and will come to this Court unless this question is finally settled.

II.

THE CIRCUIT COURT OF APPEALS MISCONSTRUED SECTION 31 (b) AS TO THE MEANING AND APPLICATION OF THE TERM "MOST RECENTLY ACCUMULATED PROFITS AND SURPLUS" AS THERE USED.

The Record shows that The B. F. Goodrich Company had made no profits for the year 1917 prior to July 2nd of that year, and that in fact the most recently accumulated profits of the Company up to July 2nd were the profits and surplus of 1916, from which the dividends in question were actually made.

(a) The Circuit Court of Appeals construed Section 31 (b) relative to the meaning of the "most recently accumulated profits" as therein used, but stated that its construction *"can not be spelled out in the very words of the law."*

The bare reading of Section 31 (b) shows that the Court was correct in this statement. But this Court has many times held that a construction and meaning which is not found in the words of a tax law should not be adopted and can not be applied.

In *United States vs. Merriam,* 263 U. S. 179, this Court said in the opinion (page 187):

> "On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms and expressions. But in statutes levying taxes, the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. *Gould vs. Gould,* 245 U. S. 151, 153."

The Court then quotes and adopts the opinion of Lord Cairns in *Partington vs. Attorney General,* 4 H. L. 100, 122, which reads in part:

> "If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown seeking to recover the tax *cannot bring the subject within the letter of the law,* the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."

Eidman vs. Martinez, 184 U. S. 578, 583;
Smietanka vs. First Trust and Savings Bank, 257 U. S., 602, 605, 606.

(b) The holding that, for the purpose of determining from what year's profits a dividend distribution is deemed to have been taken, "most recently accumulated profits" within the provisions of Section 31 (b) did not mean those of the current year which in fact had come into existence before the dividend distribution,—is unwarranted.

It is contrary to the express language of the Act which provides that "any distribution made to the shareholders * * * of a corporation * * * shall be deemed to have been made from the most recently accumulated undivided profits or surplus, etc." As used in Section 31 (b), the "most recently" accumulated profits can have no other ordinary meaning than, *before or up to the time of such distribution.* It certainly cannot mean, *after* the distribution has been made. It has been the universal understanding of taxpayers, the Revenue Department and Board of Tax Appeals, as well as the courts, that "most recently accumulated" referred to a time prior to the distribution.

In Article 107 of Regulations 33, adopted January 3, 1918, this construction is found.

After giving the requirements of Section 31 (b), this regulation reads:

> "Thus if a corporation distributed dividends in 1917, such dividends will be deemed to have been paid from the earnings of 1917, and the recipient, if an individual, will be liable to additional tax, if any, and if a corporation to income tax, at the rates for the year 1917, unless it is shown to the satisfaction of the Commissioner of Internal Revenue, *that at the time such dividends were paid the earnings up to that time were not sufficient to cover the distribution,* in which case the excess over the earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years, etc."

On February 28, 1918, Treasury Decision No. 2759 was published and on March 28, 1918, Treasury Decision No. 2678 was published. In both of these decisions the construction of the law that most recently accumulated earnings would mean earnings up to the date of payment was announced.

In *Appeal of Harmon W. Hendricks,* 4 Board of Tax Appeals, page 3251 (decided September 30, 1926), the Board of Tax Appeals held that under Section 31 (b) of the 1917 Act, dividend distributions were to be deemed made from the earnings of the corporation made prior to the time of the distribution.

The decision of the Circuit Court of Appeals therefore, is in conflict with the regulations and rulings of the Treasury Department, and with the holding of the Board of Tax Appeals.

(c) The ruling that within the meaning of Section 31 (b) the "most recently accumulated" profits, are those which are "*finally ascertained and entered* as the profits for the entire year during which dividends are paid," and are to be "judged from the end of the fiscal year during

which the income was received,"—is also erroneous and unwarranted. Nothing in the act gives warrant to such a construction, and it is in plain conflict with the decision of this Court in *Edwards vs. Douglas,* 269 U. S. 204.

In *Edwards vs. Douglas,* the corporation had made profits for the year 1917 sufficient at all times to pay all dividend distributions and it was the sole claim of the taxpayer that within the meaning of the law, a surplus account or an undivided profits account, determined as of the end of the year, and entered on the books of the corporation, was contemplated and required by the Act; and that throughout the year 1917 the most recent surplus or undivided profits accounts *so determined and entered* were those of 1916.

Dealing with this claim, this Court expressly held that the law *did not* limit profits and surplus from which dividend distributions were deemed taken, to final entries upon books of account kept for that purpose, determined as of the end of the fiscal year; and held that within the intent of Section 31 (b) for the purpose of determining what were the "most recently accumulated" profits, current earnings were to be included and regarded. This determination was elaborately discussed in the opinion.

The conclusions announced by the Circuit Court of Appeals, were undoubtedly based upon one isolated paragraph in the opinion of Mr. Justice Brandeis, the meaning of which was misconstrued and misapplied, namely—

> "Its general aim was clearly to make the dividend, in whatever year paid, bear the *tax rate* of the year in which the profits of which it was a distribution had been earned, and for *this purpose* to treat as a unit the profits of the whole year." (Italics ours).

In other words, for the purpose of making all of the profits of any one year bear the same tax rate, it was the intention of Congress to treat as a unit all of the

profits earned during the whole tax year; and whenever any profits are distributed as dividends they shall bear the *tax rate* of the year in which they were earned.

It is one thing to treat as a unit the profits of a whole tax year for the purpose of determining the *tax rate* on such profits "in whatever year paid" as dividends. It is quite a different thing to treat such profits as a unit for the whole tax year for the purpose of determining what should be deemed to be the most recently accumulated profits of a corporation up to the time of a dividend distribution, even though no profits had been made to that time.

It is certain that neither Mr. Justice Brandeis nor the Court intended to say that a dividend distribution made early in 1917 when no 1917 profits existed, was to be deemed made out of 1917 profits earned in the last part of the year.

The decision of the Circuit Court of Appeals again illustrates the error, lately pointed out by this Court, of taking a single passage, without regard to the entire context and real holding of the opinion.

In *Oklahoma vs. Texas*, 47 Sup. Ct. Rep. No. 1, 9-16, this Court stated:

> "The effect of a decree as an adjudication conclusive upon the parties, is not to be determined by isolated passages in the opinion considering the rights of the parties, but upon an examination of the issues made and intended to be submitted, and which it was intended to decide. *Vicksburg v. Henson*, 231 U. S. 259, 272, 273, 34 S. Ct. 95, 58 L. Ed. 209; *United Shoe Mach. Co. v. United States*, 258 U. S. 451, 460, 42 S. Ct. 363, 66 L. Ed. 708."

Respectfully submitted,

S. M. Jett,
Horace Andrews,
Counsel for Petitioner.

No. 152

IN THE

Supreme Court of the United States

OCTOBER TERM, 1927.

F. H. MASON,

Petitioner,

against

C. F. ROUTZAHN, Collector of Internal Revenue for the Eighteenth District of Ohio,

Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

TEXT OF:

Section 31, Revenue Act of 1917,

***Edwards* v. *Douglas*, 269 U. S. 204,**

***Appeal of Stange*, 1 B. T. A. 810.**

SECTION 31 OF THE REVENUE ACT OF 1917.

"SEC. 31. (*a*) That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

(*b*) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

EDWARDS, COLLECTOR, *v.* DOUGLAS ET AL., EXECUTORS.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

No. 129. Argued April 17, 1925.—Decided November 23, 1925.

Section 31 (b), added by the Revenue Act of 1917 to the Revenue Act of 1916, provides: "Any distribution made to the shareholders . . . of a corporation . . . in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, . . . but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen . . ." Construing this, *Held:*

1. Where the net profits of a corporation, during the fiscal year in which dividends are paid, are sufficient to cover such dividends, the term "most recently accumulated undivided profits" applies to such current earnings, and the dividends must be deemed to have made from them and are subject to the income tax rates of that year, although, when the distribution was made, there were other funds, adequate to meet it, carried in the surplus account of the corporation, as made up to the end of the preceding fiscal year. Pp. 207, 215, 217.
2. The term "surplus" as employed in corporate finance and accounting designates an account on the books, representing the net assets of the corporation in excess of all liabilities, including its capital stock. P. 214.
3. As used in § 31 (b) *supra*, "surplus" means that part of the surplus which was derived from profits, which, at the close of earlier annual accounting periods, were carried into the surplus account as undistributed profits. *Id.*

4. "Undivided profits" has not acquired a fixed meaning in corporate finance and accounting; in § 31 (b) *supra*, there is reason to conclude, it refers to profits which have neither been distributed as dividends nor carried to surplus account upon the closing of the books,—that is, to current undistributed earnings. P. 214.
5. The general aim of Congress, when enacting the above legislation, was to make the dividend, in whatever year paid, bear the tax rate of the year in which the profits of which it was a distribution had been earned, and for this purpose to treat as a unit the profits of the whole tax year; coupled with which was the special aim of making the war profits pay the high war taxes, to which end it was essential that the law, in determining the applicable tax rate, should neither accept any declaration of the corporation as to what year's profits were being distributed, nor adopt the earliest year (since March 1, 1913) of which there were accumulated profits available for distribution. P. 216.

298 Fed. 229, reversed.

CERTIORARI to a judgment of the Circuit Court of Appeals which reversed a judgment of the District Court adverse to the plaintiffs, Douglas et al., in their action to recover from the defendant Edwards the amount of an income tax assessment which they paid to him, as Collector, under protest. See 287 Fed. 919.

Mr. Alfred A. Wheat, Special Assistant to the Attorney General, with whom *Solicitor General Beck* and *Mr. Richard S. Holmes,* Special Assistant to the Attorney General, were on the brief, for petitioner.

Messrs. Matthew C. Fleming and *Paul Armitage,* with whom *Messrs. Archibald Douglas* and *Edward Holloway* were on the brief, for respondents.

MR. JUSTICE BRANDEIS delivered the opinion of the Court.

Section 31 (b), added by § 1211 of the Revenue Act of 1917, c. 63, Title XII, 40 Stat. 300, 338 to the Revenue Act of 1916, provides: "Any distribution made to the

shareholders . . . of a corporation . . . in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, . . . but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen. . . ."

James Douglas received from Phelps Dodge Corporation in September and December, 1917, two dividends, called at the time "depletion dividends," aggregating $328,400. He, and later his estate, claimed that these dividends were not taxable because they were a return of capital, not income. The Commissioner of Internal Revenue insisted that they were taxable, and assessed the tax at the 1917 rate. It amounted to $173,579.72. The estate paid the tax under protest, and brought, in the federal court for southern New York, this suit against the Collector to recover the full amount so paid. The contention was repeated that the dividends were not taxable because not constituting income. In addition it was claimed that, if they were taxable at all, it was not at the 1917 rate, but at the rate for 1916. The income tax rate imposed upon individuals for the calendar year 1917 by the 1917 Revenue Act was much higher than that imposed for the year 1916 by the Act of September 8, 1916, c. 463, Part I, 39 Stat. 756. The District Court concluded that the dividends were income and that they were taxable at the 1917 rate. It entered judgment for the Collector. 287 Fed. 919.

This judgment was reversed by the Circuit Court of Appeals. It agreed with the District Court that the dividends were not a distribution of capital. But it found

that there was on hand on December 31, 1916, in the surplus account, a balance of profits earned in that year amply sufficient to enable the corporation to pay these dividends out of such surplus; held that by reason thereof the dividends received by Douglas should have been taxed under § 31 (b) at the 1916 rate; and ordered that a mandate issue directing the District Court, upon a new trial, to enter judgment for the Douglas estate in accordance with its conclusions. 298 Fed. 229. This Court granted a writ of certiorari. 266 U. S. 596. The assertion of the estate that the dividends were a distribution of capital was not renewed in this Court; and the character assigned to the dividends by the corporation was treated here as of no legal significance. The sole question requiring decision[1] is whether these dividends paid in 1917 shall be deemed to have been paid out of the earnings of that year or out of an accumulated surplus built up in 1916 and earlier years. The question does not concern the corporation. The stockholder is interested only because he is an income tax payer.

The Government contends that the phrase "most recently accumulated undivided profits or surplus" in § 31 (b) includes current earnings of the year in which the dividends are paid; and that, as the earnings of 1917 were ample to pay these dividends, the 1917 dividends are conclusively presumed to have been paid out of 1917 earnings. The fiscal year of Phelps Dodge Corporation coincides with the calendar year. The corporation earned in 1917 a net profit of $16,742,487.06. The two distributions here involved amounted to only $3,600,000. The corporation paid from time to time during 1917, in all, ten

[1] The estate had also contended that the word "deemed" merely "gave rise to a rebuttable presumption, subject to be rebutted by showing the fund out of which the corporation actually paid the dividend." This contention was denied by both lower courts and was not made in this Court.

dividends aggregating $14,400,000. A large excess remained, to be added to the surplus account on closing the books as of December 31, 1917. There was no suggestion by the Douglas estate that, when these dividends were paid, the current undistributed 1917 earnings of the corporation then accrued were in fact insufficient to pay the two dividends. The District Court found that, under a *pro rata* apportionment, they were "more than sufficient." It is not suggested that the approximate amount of the undivided current earnings of 1917 accrued and undivided at the times these dividends were paid was not in fact known to be sufficient for this purpose. Nor is it suggested by the Douglas estate that the exact facts, or the knowledge thereof by the corporation at the times when the dividends were declared or paid, are of legal significance.

The claim of the Douglas estate is that the current profits are not, within the meaning of the Act, the "most recently accumulated undivided profits or surplus," from which the distributions "shall be deemed to have been made"; and that what Congress intended was that a dividend should be deemed to have been paid from the most recent accumulation of profits which, before payment of the dividend, appeared on the books as having been added to the undivided profits or surplus account of a fiscal year. The argument is that the income tax is levied generally with reference to the period of a full year; that the net financial results of the full calendar and fiscal year of a corporation cannot be known until the expiration of the fiscal year; that the words used by Congress have in corporate accounting a well known technical meaning; that this meaning is earnings which have been determined by the taking of inventories and the balancing of books to constitute "undivided profits or surplus"; that it was after December 31, 1917, before the net financial results of the operations of that year were formally and

definitely determined by this corporation by the usual taking of the annual inventory, the balancing of the books, and the carrying of the "undivided profits or surplus" to the appropriate account; that the most recently accumulated undivided profits so appearing was the undistributed balance of the profits earned in the year 1916, which was shown on the books as closed under date of December 31, 1916, and appeared in the surplus account; that this balance was sufficient in amount to meet these two dividends; and that it must be deemed to have been applied in paying them. In short, the claim of the Douglas estate is that Congress, in providing by § 31 (b) that dividends shall be deemed to have been paid "from the most recently accumulated undivided profits or surplus," meant from such balance as, at the time of the payment of the dividend, is shown by the undivided profits or surplus account of the preceding fiscal year.

The Douglas estate, apparently, does not contend that under the 1917 Act dividends are not to be taxed at all unless there was an existing balance of taxable profits in the surplus or undivided profits account from which they can be considered to have been paid. To have so contended would have been to impute to Congress the intention of exempting from taxation the dividends received in 1917 by those individuals who were stockholders in corporations which earned in 1917 large sums and paid them out in dividends during that year,[2] but which had no earned surplus at the close of their fiscal year on De-

[2] This, as a business matter, could easily be done, and is, in fact, done by many corporations. Nearly every business with a well developed accounting system can, at any time, without the formal periodic inventory or closing of its books usual at the end of a fiscal year, determine approximately the amount of its current earnings, the amount accrued since the beginning of its fiscal year, and the part thereof undistributed. Many corporations do make such approximate ascertainment of profits monthly, or oftener. And, relying upon their system of cost-accounting, they make distributions of current

cember 31, 1916, or whose earned surplus consisted wholly of profits earned prior to March 1, 1913. The Douglas estate grafts upon the section an implied condition or limitation. Its position seems to be that § 31 (b) applies if, and only if, at the time of the payment of the dividend, there was on hand an undistributed part of the taxable earnings of some prior fiscal year or years. In other words, it asserts that Congress, in providing that a distribution to shareholders should "be deemed to have been made from the most recently accumulated undivided profits or surplus," implied the condition—"if there are such accumulated profits or surplus not exempt from taxation"; that if there are available no such undivided profits or surplus, accrued subsequent to March 1, 1913, the distribution will be considered to have been made from current earnings; that such dividends, in that event, would be taxable as income under § 2 (a) of the Revenue Act of 1916, 39 Stat. 757, as amended by § 1200 of the 1917 Act, 40 Stat. 329; and that the 1917 rates would apply. Whether, at the time these 1917 dividends were paid, there was in the surplus account as of December 31, 1916, such funds sufficient for their payment, as the Court of Appeals appears to have found, we have no occasion to consider. For we are of the opinion that, in any event, the District Court was right in holding that these 1917 dividends must be deemed to have been paid out of the 1917 earnings, and that the stockholder was taxable thereon at the 1917 rate.

The legislative history of § 31 (b) is relied upon by the Douglas estate in support of its construction. On

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earnings without a closing of the books, as the Phelps Dodge Corporation did in 1917.

This is shown by the record to be true of the Phelps Dodge Corporation. It paid during 1917 regular and extra dividends on June 28, on September 28, and on December 28, aggregating $8,100,000, which were declared, in its report to stockholders, to have been paid by it "out of earnings for the year 1917."

the other hand, the Government relies upon the legislative history of the Revenue Act of 1918, Act of February 24, 1919, c. 18, 40 Stat. 1057, passed by the same Congress which enacted the Revenue Act of 1917. Enquiries into the detail of legislative history are sometimes helpful in removing a doubt presented by the language used in a statute. *Penn Mutual Life Ins. Co.* v. *Lederer,* 252 U. S. 523, 537. But we have no occasion here to resort to that aid in construing the phrase in question. To ascertain its meaning, we need only bear in mind the general character of the income tax, the specific practices of corporations concerning profits and dividends, the prior income-tax legislation, to which § 31 (b) is an amendment, and the time of the latter's enactment.

Ordinarily, an income tax is laid upon all taxable income actually received during the tax-year and the tax is payable at the tax-rate of the year in which it is received, although none of the income may have been earned by the taxpayer during that year, or, where the income consists of dividends, although the corporation may not have earned in that year any part of the profits of which the dividend is a distribution. The Act of October 3, 1913, c. 16, § II, 38 Stat. 114, 166, the first income-tax law enacted after the adoption of the Sixteenth Amendment, was construed by the Treasury Department as embodying this general rule without any exception. Consequently, the Treasury enacted such payment on account of all income received by the taxpayer after March 1, 1913, the effective date of the Amendment, although it appeared that all of the income had been earned before that date either by the taxpayer or by the corporation whose profits were distributed as a dividend. The correctness of the Treasury's construction was questioned; and before the second income tax law was enacted, September 8, 1916, c. 463, Title I, 39 Stat. 756, lower federal courts had in *Lynch* v. *Hornby,* 236 Fed. 661, held the Treasury

construction to be erroneous. There had also been serious contention that, as construed by the Treasury, the provision was, when applied to dividends, both unconstitutional and unjust.[3] These contentions apparently prevailed with Congress when, in framing the 1916 Act, it raised the normal tax-rate from 1 per cent. to 2 per cent. and the maximum additional tax (super-tax) from 6 per cent. to 13 per cent. The 1916 Act, by a proviso to § 2, limited the tax on dividends to distributions "made or ordered to be made by a corporation . . . out of its earnings or profits accrued since March first, nineteen hundred and thirteen . . ." Soon after came the War; the great need of the Government for large revenues; and the large war-profits. Congress enacted the 1917 War Income Tax Law, which raised the normal tax rate to 4 per cent. and the maximum additional tax to 63 per cent.; and it made the provision retroactive, in the main, to January 1, of that year.

While the 1917 Act was under consideration, it was recognized that this rapid increase in the income tax rate might result in unjust discrimination if no change were made in the then existing rule governing the taxation of dividends. All profits earned by members of a partnership would be taxed at the rate prevailing in the year in which they were earned, although actually withdrawn in a later year when the tax rate was much higher. On the other hand, the tax upon the profits of a corporation earned in 1916 or earlier, would, if paid out in 1917 as dividends, be taxed at the high 1917 rates. There would be similar discrimination among the holders of stock in different corporations. The stockholders in those corporations which had deferred the distribution of profits

[3] The decision of this Court of *Lynch* v. *Hornby*, 247 U. S. 339, which sustained the Treasury's construction and held the act constitutional, was not rendered until June 3, 1918. See also *Peabody* v. *Eisner*, 247 U. S. 347.

earned prior to 1917, either generally from prudence or specifically with a view to stabilizing over a long period the rate of dividend, would be at a great disadvantage as compared with the stockholders in those corporations which had pursued the practice of distributing each year substantially all profits earned. On the other hand, if corporations were left free to determine out of what year's profits dividends paid in 1917 and subsequent years should be deemed to have been made, a corporation with a surplus derived from earnings made prior to 1917 could, while accumulating the profits of the war years, pay dividends on which its stockholders would escape the heavy war tax, by simply declaring that the dividends were payable out of the earnings of earlier years. And if there were still on hand such sufficient surplus earnings from the period prior to March 1, 1913, the dividends would be exempt from all tax. It was apparently to obviate such inequalities that Congress provided by § 31 (b) for an objective consideration of the date when the corporation earned the profits, as well as the date when the taxpayer received his share of them in the form of the dividend. By implying the condition stated above, the Douglas estate escapes from a position which would otherwise impute to Congress the intention of enabling the war profits of 1917 and subsequent years, actually distributed as dividends, to escape from the war taxes. But in implying the condition it imputes to Congress, which was seeking to prevent discrimination against stockholders in those corporations which had on January 1, 1917, surplus profits earned since March 1, 1913, the intention of grossly discriminating in their favor. For if this condition is read into the Act, stockholders in corporations which had no such surplus on December 31, 1917, are taxable on 1917 dividends at the high 1917 rates; while those in corporations which had such surplus are taxable on 1917 dividends at the lower rates of 1916 or earlier years.

Congress did not use the words "surplus account" or "undivided profits account." Its language is "undivided profits or surplus." The word "surplus" is a term commonly employed in corporate finance and accounting to designate an account on corporate books. But this is not true of the words "undivided profits." The surplus account represents the net assets of a corporation in excess of all liabilities including its capital stock. This surplus may be "paid-in surplus," as where the stock is issued at a price above par. It may be "earned surplus," as where it was derived wholly from undistributed profits. Or it may, among other things, represent the increase in valuation of land or other assets made upon a revaluation of the company's fixed property. See *La Belle Iron Works* v. *United States,* 256 U. S. 377, 385. As used in § 31 (b) the term undoubtedly means that part of the surplus which was derived from profits which, at the close of earlier annual accounting periods, were carried into the surplus account as undistributed profits. On the other hand, the term "undivided profits" has not acquired in corporate finance and accounting a like fixed meaning. It is not known as designating generally in business an account on the corporation's books, as distinguished from profits actually earned but not yet distributed.[4] Few business corporations establish an "undivided profits" account.[5] By most corporations the term "undivided profits" is employed to describe profits which have

[4] The Committee on Accounting Terminology of the American Association of Public Accountants was for years engaged in preparing a list of definitions. That contained in the Year Book of 1913, pp. 176-227, gives at p. 226 this definition: "Undivided Profits—Earnings or profits which have not been divided among the partners in a firm or the stockholders in a corporation."

[5] The Interstate Commerce Commission prescribes for the various classes of corporations subject to its supervision about 13 different forms of accounts, all of which include a general balance sheet. The number of items on the liability side of this balance sheet varies in

neither been distributed as dividends nor carried to surplus account upon the closing of the books; that is, current undistributed earnings.

That this is the natural meaning of the term "undivided profits" is indicated by the action of both Douglas and his estate.[6] That this is the meaning in which it was used by Congress is confirmed by the use of the expression "earnings and profits" later in the same paragraph,[7] and, also, by the use of the term "undivided profits" in § 207.[8] If it be accepted as the meaning in which Con-

these several forms from 8 to 33. There is no item "undivided profits" in any form.

By incorporated banks the term is commonly employed to designate the account in which profits are carried more or less temporarily, in contradistinction to the account called surplus in which are carried amounts treated as permanent capital, and which may have been derived from payments for stock in excess of par, or from profits which have been definitely devoted to use as capital. See *Fidelity Title & Trust Co.* v. *United States*, 259 U. S. 304, 308.

[6] Douglas received (see note 2, *supra*) from Phelps Dodge Corporation during 1917 six other dividends, aggregating $738,900, which were confessedly paid out of the 1917 profits—and which were reported by him as taxable in his return to the Commissioner of Internal Revenue. The two dividends here in question were reported by him in his return as not taxable solely on the ground that they were "depletion dividends." It was on this ground only that the estate, in its applications to the Treasury, sought recovery of the amount in suit.

[7] § 31 (b) " . . but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

[8] In § 207 of the same Act, which deals with the War Excess Profits Tax on corporations and makes the tax dependent on the amount of the invested capital, the term "undivided profits" is likewise used.

gress used the words, the course to be pursued under § 31 (b) becomes consistent with the general purpose evidenced by other parts of the Act. Its general aim was clearly to make the dividend, in whatever year paid, bear the tax rate of the year in which the profits of which it was a distribution had been earned; and for this purpose to treat as a unit the profits of the whole tax year. In providing measures for the attainment of that aim, it could be of no practical significance whether, at the time of the payment of the dividend, these profits appeared in a surplus or undivided profits account (as the profits earned within part of a year would, where a corporation closed its books monthly, quarterly, or semi-annually) or whether they still rested as current earnings without formal determination or specific allocation.

Besides this general aim, Congress had the special aim of making the war profits pay the high war taxes.[9] To this end it was essential that the law should, in determining the applicable tax rate, disregard any declaration of the corporation as to what year's profits were being distributed. Not only was it essential that every such declaration of the corporation should be disregarded, but also that the dividend should not thereupon be deemed to have been paid from the profits of the earliest year (since March 1, 1913) of which there remained accumulated

That section, in paragraph (a) 3 defines invested capital as including "paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year."

[9] To discourage the hoarding of profits in order to avoid the tax, two supplemental provisions were incorporated in the Act. By § 3, incorporating § 3 of the Revenue Act of 1916, Congress taxed as income received by the stockholder his proportion of profits earned by the corporation and fraudulently hoarded by it to avoid payment of the tax. By § 1206 (2), adding § 10 (b) to the Revenue Act of 1916, it subjected the corporation to an additional tax of 10 per cent. on undistributed income not employed in the business, unless invested in obligations of the United States.

profits available for distribution. To accomplish the purpose of Congress it was necessary that the dividend be deemed to have been paid out of the available profits or earnings of the most recent year or years. Its intention so to provide was adequately expressed by the use of the phrase "most recently accumulated" in connection with the words "undivided profits or surplus." As, in the case at bar, there were profits of the year 1917 ample to cover all dividends, those here in suit must be deemed to have been paid therefrom.

Reversed.

MR. JUSTICE VAN DEVANTER, MR. JUSTICE MCREYNOLDS, MR. JUSTICE SUTHERLAND, and MR. JUSTICE BUTLER, dissent.

Appeal of A. H. STANGE. Docket No. 553.

A resolution of the board of directors of a corporation directing that a surplus fund be placed to the credit of the stockholders, "to be paid to the stockholders when and as directed by the officers or directors," constitutes a dividend at the time the resolution was passed.

A dividend declared by a corporation in 1917, prior to August 6 of that year, out of a surplus existing at March 1, 1913, is not taxable to its stockholders as income even though the corporation had earrnings or profits in the years in which payment was made out of which the dividend could have been paid.

The Board has no jurisdiction to consider an appeal filed by a taxpayer on behalf of other taxpayers similarly situated, who do not join in the appeal.

Submitted January 21, 1925; decided March 18, 1925.

W. W. Spaulding, Esq., and *Allen R. Smart, C. P. A.*, for the taxpayer.

A. Calder Mackay, Esq., for the Commissioner.

Before IVINS, KORNER, and MARQUETTE.

This is an appeal by the taxpayer from a determination of the Commissioner proposing to assess additional taxes for the years 1918 and 1919. From the stipulation of facts presented at the hearing the Board makes the following

FINDINGS OF FACT.

The A. H. Stange Co. is a corporation the entire capital stock of which is held by the taxpayer herein and nine other members of his family. On January 27, 1917, the board of directors of the A. H. Stange Co. passed a resolution as follows:

Whereas, * * * prior to the enactment of the Federal Income Tax Laws our mill and factory plant account which for a number of years had been carried at the nominal sum of $25,000 * * * and

Whereas, in order to establish a proper basis of accounting due to said loss, it was necessary to raise the value of our mill and factory plant from $25,000 to a fair value of $150,000, as shown by entry on our books under date of February 13, 1912, and

Whereas, said increased valuation was on said date erroneously credited to "surplus account," be it

Resolved, That we charge "surplus account" with the said sum of $125,000 and place this amount to the credit of the stockholders, to be paid to the stockholders when and as directed by the officers or directors, and the Secretary is hereby instructed to have proper entries made on the books of the company under date of January 27, 1917, to conform herewith.

On said 27th day of January, 1917, there was credited to the account of each of the stockholders of the said A. H. Stange Co. his proportionate share of the said dividend, and the amount of the dividend was actually paid as follows:

Aug. 8, 1917	$14,000
Sept. 5, 1917	21,000
Nov. 20, 1918	49,000
Jan. 13, 1919	41,000
Total	125,000

For the years from 1913 to 1917, inclusive, the gains and losses of the A. H. Stange Co. were as follows:

	Loss	*Gain*
1913	$19,710.14	
1914	133,600.10	
1915	136,628.55	
1916	21,284.32	
1917		$41,590.24

In the years 1918 and 1919, the corporation had earnings and profits sufficient to pay the amounts actually paid in those years. The Commissioner proposes to tax the amounts actually paid in each of the years as dividends in those years, upon the ground that the corporation had sufficient earnings and profits in each year out of which such distribution could have been paid, and upon the further ground that the resolution declaring the dividend provided that it was to be paid when and as directed by the officers and directors of the corporation.

DECISION.

The determination of the Commissioner is disapproved and the Board determines that no part of the dividend de-

cleared on January 27, 1917, is taxable to the taxpayer herein as income. The amount of the deficiency to be assessed will be settled on consent or on seven days' notice under Rule 50.

OPINION.

MARQUETTE: The question for decision herein is whether the dividend declared by the directors of A. H. Stange Co. on January 27, 1917, is exempt from taxation as income to its stockholders, or whether it is taxable to them in the years in which it was actually paid. The taxpayer contends that, as the dividend was declared prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913, it is not taxable income to him, irrespective of the fact that at the time it was paid the corporation had earnings or profits out of which payment could have been made.

The position of the Commissioner is that the words *any distribution made*, as used in the Revenue Acts of 1917 and 1918 with respect to dividends, has reference to the time of payment, and, as the corporation had sufficient earnings or profits in each of the years in which payment was made out of which such payment could have been made, the statute conclusively presumes that the distribution was made from those earnings or profits.

Section 31 of the Revenue Act of 1916 (added by section 1211 of the Revenue Act of 1917), relating to dividends, is as follows:

Sec. 31. (a) That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, * * *.

(b) Any distribution made to the shareholders or members of a corporation * * * in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation * * *, but nothing herein shall be construed as taxing any earnings or profits accrued

prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed * * * exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. *This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.* (Italics ours.)

The pertinent parts of the Revenue Act of 1918 are as follows:

Sec. 201. (a) That the term "dividend" when used in this title * * * means (1) any distribution made by a corporation * * * to its shareholders or members, whether in cash or in other property * * * out of its earnings or profits accumulated since February 28, 1913, * * *.

(b) Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed. Any distribution made in the year 1918 or any year thereafter shall be deemed to have been made from earnings or profits accumulated since February 28, 1913, * * *; but any earnings or profits accumulated prior to March 1, 1913, may be distributed in stock dividends or otherwise, exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

It is not disputed that at March 1, 1913, the A. H. Stange Co. had undivided profits or surplus in the amount of $125,000, or that a resolution of the board of directors of that company was passed on January 27, 1917, purporting to distribute that surplus to its stockholders. A question preliminary to the main issue has been made to the effect that, as the resolution provided for payment "when and as directed by the officers or directors," it did not become a dividend until the time for payment was fixed. We think this contention is without merit. It appears to be well settled that a dividend belongs to the holders of the stock at the time it is declared and not at the time it becomes payable; that, in the absence of special circumstances, a provision postponing payment or making it payable on the order of the board of directors does not change the rule, and it becomes payable within a reasonable time. *Wallin* v. *Johnson City Lumber & Mfg. Co.*, 188 S. W. 577 (Tenn.); L. R. A. 1917 B, 323.

In *Northwestern Marble & Tile Co.* v. *Carlson,* 116 Minn. 483; 133 N. W. 1014, the board of directors of a corporation adopted a resolution "that a dividend of 6 per cent be declared on the common stock, payable * * * at such time as the finances of the firm will in the judgment of the board of directors warrant." The contention was that the resolution did not constitute a valid dividend so as to make it available to stockholders. The court said:

> If the resolution is to be construed as claimed by the plaintiff, its adoption was either an idle ceremony, for the amusement of the stockholders, or a device to inflate the selling price of the stock. Neither inference is justified by the facts. The board of directors by the resolution declared a dividend, and its action was amply justified by the surplus and undivided profits of the corporation. No further action of the board was necessary to make the segregation of the amount of the dividend of each stockholder from the common mass of the corporate property. There was no qualification of the declaration of the dividend, and its existence as a debt against the corporation was not dependent upon any further action of the board, but the debt was payable at such time as the finances of the corporation would in the judgment of the board of directors warrant. This provision as to the time of payment of the dividend must be construed in connection with the fact that a dividend had been rightfully declared and notice thereof given to the stockholders at their annual meeting. So construing the provision, we hold that the time of payment of the dividend was not a matter depending upon the discretionary future action of the board, but that it gave to the board a reasonable time in which to make the necessary arrangements for its payment; that is, the dividend was payable within a reasonable time.

See also *United States* v. *Guinzburg,* 278 Fed. 363; *Plant* v. *Walsh,* 280 Fed. 722.

From the above authorities we are of opinion that the resolution of the board of directors of A. H. Stange Co. of January 27, 1917, constituted a valid declaration of a dividend at that time, even though the payment was to be made when and as directed by the officers or directors.

The determination of the principal question herein depends, in the last analysis, upon the construction which must be given to the words *any distribution made,* as used in section 31 (b) of the Revenue Act of 1916. If these

words have reference to the declaration of a dividend, the taxpayer must prevail; if they mean the actual time of payment of a dividend, then it will be necessary to construe the limitations upon distribution of earnings and profits in said section. It is therefore necessary to ascertain the legal effect of a resolution declaring a dividend. The definition of a dividend in section 31 (a) of the 1916 Act as "any distribution made or ordered to be made by a corporation * * * out of its earnings or profits * * * and payable to its shareholders," comports with the general definition of a dividend, and for the purposes of this case may be taken as correctlly defining a dividend declared out of earnings or profits accrued prior to March 1, 1913. What, then, is the legal effect of the declaration of a dividend? We think the answer to this question is clearly set forth by the court in *United States* v. *Guinzburg*, 278 Fed. 363, wherein the court said:

> By the declartion of a dividend, the earnings of the company to the extent declared were separated from the property of the corporation, and were appropriated by that action to the then stockholders, who became creditors of the corporation for the amount of the dividend. The relation then created was that of debtor and creditor. *N. Y. Trust Co. et al.* v. *Edwards, Collector*, 257 U. S. 176, 42 Sup. Ct. 68, 66 L. Ed. 186, decided November 21, 1921; *Wheeler* v. *Northwestern Sleigh Co.* (C. C.) 39 Fed. 347; *People ex rel. U. S. Trust Co.* v. *Barker*, 86 Hun, 131, 33 N. Y. Supp. 388; *Billingham* v. *Gleason Mfg. Co.* 101 App. Div. 476, 91 N. Y. Supp. 1046, affirmed 185 N. Y. 571, 78 N. E. 1099. It is the separation of the earnings from the balance of the corporate property, together with the promise to pay arising from the declaration of the dividend, that works this change. The holder of stock, with respect to the dividend, is on a par with the other creditors of the corporation. *Staats* v. *Biograph Co.*, 236 Fed. 454, 149 C. C. A. 506, L. R. A. 1917 B, 728. The fact that the dividend is payable at a future date does not alter the rights thus created. The obligation of the corporation as debtor commences with the declaration of the dividend, although the payment is postponed for the convenience of the company. The rights of the stockholders are immediately vested the moment the dividend is declared. *N. Y. Trust Co.* v. *Edwards, supra.* The action of the board of directors is the appropriation of a portion of the earnings to the defendant in error as the holder of a certificate of stock.

See also *Plant* v. *Walsh*, 280 Fed. 722; Fletcher, Enc. Corps., sec. 3653.

The outstanding features of a dividend declaration are that, by the mere declaration, the dividend becomes thereby separated and segregated from the stock and exists independently of it; the *right* thereto becomes immediately fixed and absolute in the stockholders, and the corporation becomes a debtor to its stockholders for their pro rata shares. There is an apportionment or division of the assets of the corporation, to the extent of the dividend, to its stockholders. The corporation is at once poorer in the amount of the dividend declaration, and the stockholder becomes richer in his own right, to the extent of his pro rata share. What theretofore existed as undivided profits or surplus has become divided profits and the surplus is reduced to the extent of the dividend declared. It has ceased to be the property of the corporation and has become the property of the stockholder, and his interest therein becomes adverse to the corporation and to every other stockholder. We think this division or segregation of the amount of the dividend from the general mass of the corporate property and its apportionment to the stockholders is included in the words *any distribution made*, as used in the statute, and that those words must be given the same legal effect as results from the declaration of a dividend. It follows that the resolution of the board of directors of A. H. Stange Co., passed on January 27, 1917, constituted a distribution to its stockholders at that time of the surplus existing at March 1, 1913, and the fact that payment was made in subsequent years becomes immaterial.

It remains to apply the provisions of section 31 (b) of the 1916 Act. By that section any distribution made in the year 1917 or subsequent tax years is deemed to have been made from the most recently accumulated undivided profits or surplus, and the presumption thus raised has been held to be a conclusive presumption. *Harder* v. *Irwin*, 285 Fed. 402; *Douglas* v. *Edwards*, 298 Fed. 229. The facts herein show that A. H. Stange Co. had operated at a loss in all the years from 1912 to 1917, and there were no un-

divided profits since 1913 out of which a distribution could have been made, and this appeal could be sustained on that ground. We prefer, however, to rest our decision upon the last sentence of section 31 (b), providing:

> This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

Holding, as we do, that the words *any distribution made*, as used in the statute, include the declaration of a dividend and must have the same legal effect; and the dividend in question having been declared prior to August 6, 1917, to wit, on January 27, 1917, the presumption that the distribution was from the most recently accumulated undivided profits or surplus has no application to the facts in this appeal. We are of opinion that the distribution made by the A. H. Stange Co. to its stockholders on January 27, 1917, out of a surplus existing prior to March 1, 1913, is exempt from taxation to the taxpayer herein at the time of the actual payment, and the determination of the Commissioner proposing to tax the same in the years in which it was paid must be disapproved.

A question presents itself from the face of the petition herein which was not raised by the Commissioner; but as it relates to the jurisdiction of the Board, we feel it is our duty to take notice thereof. The taxpayer has filed a petition on behalf of himself and nine other named persons, all stockholders of the A. H. Stange Co., in which it is stated that "the issue in the case of each stockholder named is identical, which is the reason for filing one petition and asking only one hearing." The petition is not a joint petition of all the named parties, and is the petition of this taxpayer alone. We know of no authority in the law, and there is certainly none in the rules of the Board, sanctioning or permitting an appeal by one taxpayer for or on behalf of another, even though they are all stockholders in the same corporation and the same question would be raised in an appeal prosecuted by them. The statute authorizes an appeal by the *taxpayer* within 60 days after the deficiency notice is mailed, and the Board has re-

peatedly held that the filing of a petition with the Board within that time is a jurisdictional matter. *Appeal of Sam Satovsky,* 1 B. T. A. 22. We therefore decline to express any opinion on the merits of the pretended appeals filed by this taxpayer on behalf of the nine other stockholders named in his petition.

FILED
OCT 3 1927
CHARLES ELMORE CROPLEY
CLERK

No. 152

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1927

F. H. MASON,

Petitioner,

against

C. F. ROUTZAHN, *Collector of Internal Revenue* for the Eighteenth District of Ohio,

Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

Motion for Leave to File a Brief

and

Brief Submitted by Leave of Court

CHARLES E. HUGHES,
EDWARD CORNELL,
WILLIAM C. BREED,
PAUL ARMITAGE,
HARRISON TWEED,
Amici Curiae.

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Respondent.

MOTION FOR LEAVE TO FILE A BRIEF and BRIEF SUBMITTED BY LEAVE OF COURT.

MOTION.

Now come Charles E. Hughes, Edward Cornell, William C. Breed, Paul Armitage and Harrison Tweed, attorneys and counsellors of this Court, and represent that there is involved in this case a question in which they are interested on behalf of clients who have cases pending in the courts and in the Bureau of Internal Revenue, in which

dividends received during the year 1917 were declared by the board of directors of the corporation on one date and physically paid to the stockholders on a later date. The question in issue is what years' rates of taxation should be applied. In most of these cases the dividend was both declared and paid within the year 1917. In some of them, however, the dividend was declared in 1916 and paid in 1917. In both classes of cases the question is precisely the same and its determination depends upon the same considerations. The question is, however, seen more clearly if it is considered from the point of view of a case in which the dividend was both declared and paid within the year 1917.

The answer involves the interpretation of Section 31 of the Revenue Act of 1917, which is before the Court in the case at bar.

Therefore, as *amici curiae* in support of the position of the petitioner, they pray leave to file a brief in the following form:

ARGUMENT.

The Question Involved.

We shall not discuss in this brief the contention of the Government that the phrase "most recently accumulated undivided profits or surplus" refers to the profits which are finally ascertained and entered as the profits of the entire year in which the dividend is paid, because we believe that that contention is foreclosed by the decision of this Court in *Edwards* v. *Douglas*, 269 U. S. 204, and, in any event, is fully covered in the main brief filed in this case.

Section 31 of the Revenue Act of 1917, which is set forth in full in Appendix A, lays down three rules for the taxation of a dividend distribution:

> First, relating to income: That the dividend shall constitute a part of the income of the stockholder "for the year in which received" by him.
>
> Second, relating to the tax rate: That the dividend shall be taxed at the rate prevailing during the year in which the profits distributed "were accumulated by the corporation."
>
> Third, relating to the order of distribution of profits: That in determining what years' profits are distributed, the dividend "shall be deemed to have been made from the most recently accumulated undivided profits or surplus."

The question which arises can be best illustrated by an assumed case:

On February 1, 1917, the board of directors of a corporation declared a dividend the total amount of which was $100,000, payable on March 1 to stockholders of record on February 15. On December 31, 1916, the corporation had undivided profits and surplus of $1,000,000, of which $100,000 was earned during the year 1916. During January, 1917, it had neither profits nor losses. Between February 1 and March 1 it had profits of $100,000, so that the total undivided profits and surplus on the latter date was $1,100,000. On February 1 the amount of the dividend was charged against undivided profits and surplus and set up on the books as a liability to the stockholders. On March 1, the dividend checks, which in the meanwhile had been drawn, were mailed to the stockholders. Is the dividend

taxable at the rates applicable for the year 1917 or at the rates applicable for the year 1916?

What does the statute say? It says that a dividend is to be taxed at the rate prevailing during the year in which the profits distributed "were accumulated by the corporation." It says further that in determining what years' profits are distributed, the dividend "shall be deemed to have been made from the most recently accumulated undivided profits or surplus." It is perfectly clear that if the dividend is to be deemed to have been made from the $1,000,000 fund of undivided profits and surplus accumulated when it was declared on February 1, *the part* of that fund distributed by the dividend is the $100,000 earned in 1916. It is equally clear that if the dividend is to be deemed to have been made from the $1,100,000 fund of undivided profits on hand when the dividend checks were mailed on March 1, *the part* of that fund distributed is the $100,000 earned in February, 1917. There can be no question about this, for it is expressly covered by the wording of the statute. But is the dividend to be deemed to have been made from the $1,000,000 fund existing when the dividend was *declared,* or from the $1,100,000 fund existing when the dividend was *paid?* The issue is whether the profits earned after the declaration of a dividend and before its payment are to be included in the conglomerate fund of profits from which the dividend distribution is deemed to have been made. Or, to put it in another way, the issue is whether the fund out of which a dividend distribution is made is to be determined as of the date of declaration or as of the date of payment of the dividend.

The statute does not expressly specify as of what date the "most recently accumulated undivided profits or surplus" are to be determined.

In the first place it is clear that Congress has not expressly stated that profits earned *after* the declaration of a dividend are to be included in the conglomerate fund of profits from which the dividend distribution is deemed to have been made, and that the obligation is upon the courts to give a reasonable construction to the statute. Congress might, of course, have so stated by merely adding at the end of the phrase "most recently accumulated undivided profits or surplus" the words "determined as of the date of the *payment* of the dividend." But this is just what Congress did not do.

The Government admits that this is so when it argues that the date for determining the profits constituting the source of a dividend is either (a) the last day of the year in which the dividend is paid, or (b) the day on which in the following year the stockholder makes up his income tax return. Obviously, the Government could not make such an argument if the statute contained an express statement that the date for such determination is the date of the payment of the dividend. In making this argument the Government must be deemed to concede that Congress has not expressly specified a date for the determination. This is a concession which in view of the language of the statute, the Government cannot avoid.

A careful reading of subdivision (b) shows that it has not said as of what date the "most recently accumulated undivided profits or surplus" should be ascertained. It has merely said that "any distribution * * * shall be

deemed to have been made from the most recently accumulated undivided profits or surplus" and has remained silent as to the date for determining what are the "most recently accumulated undivided profits or surplus." It has not even said that the determination shall be made as of the time "when the distribution is made," whatever that phrase would have meant. Therefore, the Government would accomplish very little by establishing its contention that the words "distribution made" mean "dividend paid." The most that the statute would then say would be that a "dividend shall be deemed to have been *paid* out of the most recently accumulated undivided profits or surplus," but it would still remain silent as to the date for determining what are the "most recently accumulated undivided profits or surplus" distributed by the dividend.

Once it be admitted that Congress has not specified in Section 31 (b) the date or point of time for determining the profits constituting the source of a dividend, the question of what interpretation is to be placed upon the phrase "distribution made" becomes immaterial. If the words "any distribution made to shareholders" are not used to specify the date when the conglomerate fund of undivided profits or surplus is to be fixed, it does not matter whether the phrase "distribution made" means "dividend declared" or "dividend paid." Under such circumstances the date for the determination of the fund of which the dividend is a distribution must be sought *dehors* the statute, because, *ex concesso,* Congress has not expressly specified that date in the statute itself.

The failure of Congress to specify a date for determining the conglomerate fund of profits constituting the source of the dividend is conclusive that it intended to leave the selection of that date just where it found it, and that the selection should be made in accordance with good accounting practice, charter provisions fixing dividend dates and the rules of corporate and criminal law.

Do these rules declare that the conglomerate fund of profits from which a dividend distribution is made is the fund existing when the dividend is declared or the fund arising thereafter and existing when the dividend is paid? There can be no doubt of the answer. The corporate profits which are available for dividend distribution are those which exist at the time that the dividend is declared. It is unlawful to declare a dividend unless profits then exist. In most states it is a penal offense (see, for example, N. Y. Stock Corporation Law, Sec. 58; New York Penal Law, Sec. 664; *Liebman* v. *Auto Strop Co.*, 241 N. Y. 427). It is, therefore, to the profits existing when the directors meet that they must look to ascertain their right to declare a dividend, and to decide whether to do so. It is against the fund of profits then existing that the dividend is charged. When a dividend has been declared, the amount thereof is immediately debited against current undivided profits or accumulated surplus of preceding years. Sometimes, a dividend account is opened and when the dividend is declared its amount is set up as a credit to that account, and later, when the dividend is paid, debited to that account. But however the books are kept,

the charge against profits is always made or becomes a liability at the time of the declaration of the dividend, and it is obvious that the dividend can never, as a matter of bookkeeping, be charged against profits accumulated subsequent to the declaration of the dividend. *Nor is the method of handling the entries on the books of the corporation a mere matter of bookkeeping. The entries made reflect the underlying legal situation created by the declaration of the dividend.*

When a dividend is declared, the relation of debtor and creditor is immediately created as between the corporation and the stockholder. Money of the corporation is by the act of the directors in declaring the dividend segregated from the accumulated surplus and undivided profits existing at the time of the declaration of the dividend and appropriated to its payment. Sometimes the form of the declaration is such that this appropriation amounts to more than the creation of the relation of debtor and creditor, and a trust fund is set up for the benefit of the stockholders, to which their claim has priority over the claim of other creditors. In the court below the Government affirmatively admitted each of these propositions. It could hardly do otherwise in view of the decision in *United States* v. *Guinzburg*, 278 Fed. 353, and a multitude of other cases.

In the *Guinzburg* case the Circuit Court of Appeals held that a dividend declared on February 17, 1913, and payable July 1, 1913, was not taxable as income, saying:

> "We think that the dividend declared prior to March 1, 1913, the effective date of the Income Tax Act here considered, was not income when paid because it was part of the capital of the defendant in

error on March 1, 1913. By the declaration of a dividend, the earnings of the company to the extent declared were separated from the property of the corporation, and were appropriated by that action to the then stockholders, who became creditors of the corporation for the amount of the dividend. The relation then created was that of debtor and creditor. (Citing cases.) It is the separation of the earnings from the balance of the corporate property, together with the promise to pay arising from the declaration of the dividend, that works this change. The holder of stock, with respect to the dividend, is on a par with the other creditors of the corporation. *Staats* v. *Biograph Co.*, 236 Fed. 454, 149, C. C. A. 506, L. R. A. 1917B, 728. The fact that the dividend is payable at a future date does not alter the rights thus created. The obligation of the corporation as debtor commences with the declaration of the dividend, although the payment is postponed for the convenience of the company. The rights of the stockholders are immediately vested the moment the dividend is declared. *N. Y. Trust Co.* v. *Edwards, supra.* The action of the board of directors is the appropriation of a portion of the earnings to the defendant in error as the holder of a certificate of stock."

These principles have been recognized by this Court over and over again (see *Lynch* v. *Hornby*, 247 U. S. 339, 353, and *Eisner* v. *Macomber*, 252 U. S. 189, 219).

The date of the payment of a dividend is one which has no logical connection whatever with the actual and legal source of the dividend. The payment of a dividend is merely a clerical and ministerial act whereby checks are mailed to the stockholders. No book entry is made at that time, except one whereby the liability created by the declaration of the dividend is washed out just as any other liability is washed out on the books when paid.

The fact is that the only reason why a dividend is not paid on the day it is declared is one of convenience. Originally, and, in the case of small corporations, even today, the dividend checks are drawn on the day of the declaration of the dividend. In the case of large corporations the practice has grown up of postponing the payment as a matter of convenience. One reason why it is convenient to postpone payment is the amount of labor involved in drawing the checks. It would be physically impossible to draw the necessary number of checks and have them signed on the day that the dividend is declared. Another reason for the postponement is that it is considered desirable to give stockholders and prospective purchasers of stock advance notice of the dividend so that the stock may be bought and sold upon the basis of the approaching dividend. Thus the custom is for the board of directors to designate not only a future date for payment, but also a date as of which the registered stockholders shall be the persons entitled to receive the dividend. For example, a large corporation might declare a dividend on February 1, payable on March 1, to stockholders of record on February 15. Thus, notice is given that any purchaser of the stock who does not present his certificate for transfer on February 15 will not be entitled to receive the dividend. In order to clearly fix the respective rights of the purchaser and the seller, the New York Stock Exchange requires delivery of stock certificates to the purchaser on the day of the sale. Therefore, a purchaser of stock on February 14 could, but a purchaser on February 15 could not, present his certificate for transfer in time to become entitled to the dividend. On February 15 the stock would sell on

the Stock Exchange "ex dividend", that is to say, the purchaser on or after that day is not entitled to the dividend. On that day the stock ordinarily sells at a price which is lower by the amount of the dividend.

The importance of this procedure is two-fold. First, it indicates that the postponement of the payment of the dividend is not a matter of substance, but merely of convenience, and that what happens when the dividend is paid is nothing more than the performance of the ministerial duty of drawing and mailing the dividend checks. Second, the procedure discloses that the Government's argument that the words "distribution made" mean "dividend ~~declared~~ paid" leads to an absurdity. The statute includes only distributions "made to the shareholders". If these words mean "paid to the shareholders", then they exclude a dividend received by the seller of stock "ex dividend", for, though he is a shareholder at the time the dividend is declared, he is not a shareholder when the dividend is paid and the transfer has been made on the books of the corporation.

When we come to consider the circumstances under which Section 31(b) was enacted and the purposes which Congress had in mind, it becomes clear that there is no reason for a departure from, but rather a necessity for an adherence to, established rules of law and accounting for determining the source of a dividend. These circumstances and purposes are clearly pointed out in the opinion of Mr. Justice Brandeis in *Edwards* v. *Douglas*, 269 U. S. 204, 211. It is clear that the main purpose of Congress was to provide that, subject only to the conclusive presumption of distribution in the inverse order of

accumulation, a dividend should be taxed at the rate applicable to the year in which the profits which it *in fact* distributed had been accumulated by the corporation, so that war earnings, and war earnings only, should be taxed at war rates. The Government seeks to defeat this purpose by setting up an arbitrary and illogical test for determining what profits are distributed by a given dividend —a test whereby the profits deemed to be distributed are profits which did not exist when the dividend was declared and when the right of the stockholder to receive the dividend became fixed and irrevocable. In doing so, it ignores the controlling consideration that the statute must be construed in the light of the corporate facts to which it applies.

The words used by Congress are entirely appropriate to express its purpose.

Congress said that "any distribution made to the shareholders or members of a corporation * * * shall be deemed to have been made from the most recently accumulated undivided profits or surplus". It used the phrase "distribution made" because that was the natural and normal and, perhaps, the only phrase to use. It could not use the phrase "dividend paid" or "dividend declared" because the use of the word "dividend" would have brought into play the definition of a dividend contained in subdivision (a). If in subdivision (b) Congress had referred to "any dividend paid" or "any dividend declared", the word "dividend" would have been cut down in its meaning by the definition in sub-

division (a) so as to include only distributions made or ordered to be made out of profits accrued *since* March 1, 1913. In other words, a dividend which by special resolution of the board of directors was payable out of profits accrued *prior* to March 1, 1913, would not have come within the provisions of subdivision (b). Clearly, Congress did not wish to exclude such dividends from the provisions of subdivision (b). Therefore, it used the word "distribution" instead of the word "dividend", and selected the verb appropriate to the noun "distribution". A distribution, unlike a dividend, is not declared or paid, but is *made*.

Now, when Congress said that a "distribution * * * shall be deemed to have been made from the most recently accumulated undivided profits or surplus", did it intend to fly in the face of corporate law and practice and instead of permitting that law and practice to designate as the source of the dividend the profits on hand at the time of the declaration, arbitrarily to lay down an utterly inconsistent rule designating as the source of the dividend the profits on hand when the dividend was paid? We doubt whether, even if Congress had used the phrase "dividend paid" instead of the phrase "distribution made", such an intention could fairly have been attributable to it. It would have required something more than this general reference to the payment of a dividend—something in the nature of a specific reference to the profits "existing as of the date of the payment of the dividend"—to justify the conclusion that Congress so intended.

But Congress did not use the phrase "dividend paid". It used the more generic and broader phrase "distribution made". That it did not attach to that phrase the

meaning "dividend paid", is clear from the use of the same phrase in the proviso at the end of subdivision (b), which reads:

> "This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

The purpose of this proviso was to keep faith with the stockholders of corporations the directors of which, in reliance upon the existing law and before they had notice of the proposed change in the law, had expressly declared a dividend to be payable out of surplus existing on March 1, 1913. Congress said that that notice had been given on August 6, 1917. It said that any 'distribution made" prior to that date out of surplus existing on March 1, 1913, should not be affected by the amendment. Did it mean dividends which had been declared or dividends which had been paid before August 6th? Clearly, it must have meant dividends *declared* before that date. It was thinking not of the receipt of dividends by the stockholders or the paying out of the money by the corporation. It was thinking of the action of the directors in declaring a dividend expressly payable out of surplus existing on March 1, 1913. Therefore, when it referred to a distribution made, it must have referred to that part of the transaction which takes place when the board of directors separates a part of the undivided profits or surplus from the property of the corporation and appropriates it to the stockholders. Otherwise the purpose of Congress would in many cases be frustrated. A dividend declared on August 1 and payable on

August 15 was as much entitled to exclusion from the amendment as one declared on August 1 and payable on August 5. The distinction to be drawn was not between dates of payment, but between dates of declaration. Every dividend declared prior to August 6 was entitled to exemption. Every dividend declared after that date was properly to be subjected to the new rule of taxation. For purposes of keeping faith and being fair to stockholders, the thing which Congress intended to accomplish was the exclusion from the amendment of every dividend with respect to which action had been taken in reliance upon the then existing rules for taxation before Congress had given notice of its intention to change those rules. It cannot be questioned that that action is taken when a dividend is declared. Therefore, in that context the phrase conveys the thought and refers to the time of the declaration of the dividend.

The Board of Tax Appeals has held in *Appeal of Stange*, 1 B. T. A. 810 (1925), that a dividend declared prior to August 6, 1917, but not paid until after that date, comes within the proviso to subdivision (b) of Section 31 because the phrase "distribution made" refers to the date of the declaration of the dividend. In the opinion of the Board of Tax Appeals it is stated:

> "The determination of the principal question herein depends, in the last analysis, upon the construction which must be given to the words *any distribution made*, as used in section 31 (b) of the Revenue Act of 1916. If these words have reference to the declaration of a dividend, the taxpayer must prevail; if they mean the actual time of payment of a dividend, then it will be necessary to construe the limitations upon distribution of earnings and profits in said section. It

is therefore necessary to ascertain the legal effect of a resolution declaring a dividend. The definition of a dividend in section 31 (a) of the 1916 Act as 'any distribution made or ordered to be made by a corporation * * * out of its earnings or profits * * * and payable to its shareholders,' comports with the general definition of a dividend, and for the purposes of this case may be taken as correctly defining a dividend declared out of earnings or profits accrued prior to March 1, 1913. What, then, is the legal effect of the declaration of a dividend?

* * * * * * * *

The outstanding features of a dividend declaration are that, by the mere declaration, the dividend becomes thereby separated and segregated from the stock and exists independently of it; the *right* thereto becomes immediately fixed and absolute in the stockholders, and the corporation becomes a debtor to its stockholders for their pro rata shares. There is an apportionment or division of the assets of the corporation, to the extent of the dividend, to its stockholders. The corporation is at once poorer in the amount of the dividend declaration, and the stockholder becomes richer in his own right, to the extent of his pro rata share. What theretofore existed as undivided profits or surplus has become divided profits and the surplus is reduced to the extent of the dividend declared. It has ceased to be the property of the corporation and has become the property of the stockholder, and his interest therein becomes adverse to the corporation and to every other stockholder. We think this division or segregation of the amount of the dividend from the general mass of the corporate property and its apportionment to the stockholders is included in the words *any distribution made*, as used in the statute, and that those words must be given the same legal effect as results from the declaration of a dividend. It follows that the resolution of the board of directors of A. H. Stange Co., passed on January 27, 1917, con-

stituted a distribution to its stockholders at that time of the surplus existing at March 1, 1913, and the fact that payment was made in subsequent years becomes immaterial.

It remains to apply the provisions of section 31 (b) of the 1916 Act. By that section any distribution made in the year 1917 or subsequent tax years is deemed to have been made from the most recently accumulated and undivided profits or surplus, and the presumption thus raised has been held to be a conclusive presumption. *Harder* v. *Irwin*, 285 Fed. 402; *Douglas* v. *Edwards*, 298 Fed. 229. The facts herein show that A. H. Stange Co. had operated at a loss in all the years from 1912 to 1917, and there were no undivided profits since 1913 out of which a distribution could have been made, and this appeal could be sustained on that ground. We prefer, however, to rest our decision upon the last sentence of section 31 (b), providing:

> This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

Holding, as we do, that the words *any distribution made*, as used in the statute, include the declaration of a dividend and must have the same legal effect; and the dividend in question having been declared prior to August 6, 1917, to wit, on January 27, 1917, the presumption that the distribution was from the most recently accumulated undivided profits or surplus has no application to the facts in this appeal. We are of opinion that the distribution made by the A. H. Stange Co. to its stockholders on January 27, 1917, out of a surplus existing prior to March 1, 1913, is exempt from taxation to the taxpayer herein at the time of the actual payment, and the determination of the Commissioner proposing to tax the same in the years in which it was paid must be disapproved."

This decision was at first acquiesced in by the Treasury Department, although subsequently its acquiescence was withdrawn, presumably because it appreciated that such acquiescence was inconsistent with the position it is taking in the present case.

The Board of Tax Appeals has also held in a case where the dividends were declared in January, 1917, and paid at a later date, that the phrase "distribution made" refers to the time of the declaration and not to the time of the payment of a dividend, and that, therefore, the fund from which the dividend is deemed to have been distributed consists of the profits existing at the time of the declaration of the dividend (*Appeal of Hendricks*, 4 B. T. A. 1257). The opinion states:

> "We therefore hold that the resolution of the board of directors of Hendricks Brothers, Inc., of January 17, 1917, constituted a dividend at that time, regardless of the fact that part of the dividend was not paid until later. * * * it follows, therefore, that the distribution made by Hendricks Brothers, Inc., on January 17, 1917, was made from earnings for the period January 1 to January 17, 1917, in so far as there were such earnings."

The same decision was made by the Board of Tax Appeals in *Appeal of Stranahan* (Corporation Trust Company's Federal Tax Service, 1926, Part I, Board of Tax Appeals, Page 403).

There is every reason why the words "distribution made," as used to designate the part of the conglomerate fund from which the distribution should be deemed to have been made, should be construed to speak as of the date of

the declaration of the dividend and to refer to the profits then most recently accumulated. The purpose of the provision was to eliminate the right of the board of directors to declare by express resolution that a dividend was to constitute a distribution of the profits of a specified year, and to substitute for that right a conclusive presumption of fact and law. In accomplishing that purpose the mind of Congress was focussed upon the action of the board of directors in declaring a dividend, and the words it used speak as of that time. That is the time as of which the source of a dividend would be fixed by express resolution of the board of directors, and that is the time as of which it would properly be fixed by the conclusive presumption which Congress created. Furthermore, as the Government and the Circuit Court of Appeals frankly admitted, that is the time as of which the respective rights of the corporation and the stockholder are fixed. It is then that the distribution is made to the shareholders in every substantial sense, and there remains only the ministerial duty of drawing and mailing the checks.

In the Court below the Government attempted to give to the phrase "distribution made" the meaning "dividend paid" by calling attention to the words "made or ordered to be made" in qualification of the word "distribution" in subdivision (a). It attached to these words the significance "declared or paid." Upon this premise it built the argument that the omission of the words "ordered to be made" in subdivision (b) indicated an intention by Congress to refer to the time of payment, as distinguished from the time of declaration, of a dividend. The truth of the matter

is that the words "made or ordered to be made" in subdivision (a) were not used with the meaning "declared or paid."

Subdivision (a) of Section 31 was inserted in the original Revenue Act of 1916 in order, as Mr. Justice Brandeis has pointed out in *Edwards* v. *Douglas*, 269 U. S. 204, 212, to make it clear that dividends paid out of profits earned before March 1, 1913, should not be subject to income tax. To do this it was necessary appropriately to define "dividends." Congress accordingly said:

> "That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, * * *."

It is unquestionable that the words "made or ordered to be made" were used to make clear that there was to be included within the definition of a taxable dividend two distinct varieties of dividends. The first variety was "any distribution made * * * by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen," and *not* made payable out of the profits of a specified year by an express resolution of the board of directors. The second variety was "any distribution * * * *ordered to be made* by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen," by an express resolution of the board of directors. The use of these words in the definition of a taxable dividend had also the further effect of excluding a dividend specifically made payable

out of earnings accrued *prior* to March 1, 1913, by an express resolution of the board of directors. It was appropriate, if not, indeed, necessary, that the definition should make this inclusion and exclusion. The custom had already grown up of designating the source of a dividend by resolution of the board of directors, and Congress wished to make it clear that that practice might be continued and that it would be effectual.

Proof that this was the purpose of Congress is furnished by the language used in subdivision (a) of Section 201 of the Revenue Act of 1918. In that Act, Congress created a conclusive presumption that a dividend should be deemed to have been made from profits accumulated since March 1, 1913, thereby depriving the board of directors of the right to specify the source of the dividend, and bringing it about that profits accumulated before that date could not be distributed tax exempt until all subsequent profits had been distributed. In the definition of a dividend inserted in that Act, Congress omitted the phrase "ordered to be made" and referred only to "any distribution made by a corporation * * * out of its earnings or profits accumulated since February 28, 1913." It realized that if it left in the phrase "ordered to be made," there would have been an inconsistency between the conclusive presumption it was creating and the definition of a taxable dividend it was establishing.

This explanation of the correct meaning of the words "made or ordered to be made" would seem to be a complete answer to the main argument made by the Government in the Court below.

Another argument which the Government advanced was

that since Section 31 (b) is a part of an income tax statute, the words "distribution made" must be read in the sense of "dividend paid" because, until a dividend is physically paid, it does not constitute income of the stockholders. To construe the phrase "distribution made" otherwise, it was argued, would render the section meaningless and inapt in a statute taxing only dividends "when paid". The fallacy in this argument is that the context in which the words are used has nothing to do with the question of taxable income. The important phrase is "any distribution * * * shall be deemed to have been made from the most recently accumulated undivided profits or surplus". This phrase was not intended to designate what is income of the stockholder, for that was accomplished when, in an earlier part of the section, it was said that a dividend "shall constitute a part of the annual income of the distributee for the year in which received". On the contrary, the phrase was intended to designate the part of the composite fund of profits which should be deemed to have been distributed by the dividend. The point which Congress was there covering does not concern what is income for purposes of taxation, but what profits are distributed by a dividend. That is a matter involving corporation law rather than the law of income taxation and the Government and the Circuit Court of Appeals frankly admitted that as between the corporation and the stockholder the declaration of a dividend constitutes the distribution.

As already stated, we think that whatever meaning may be attached to the words "distribution made", it still remains clear that Congress has not specified that the con-

glomerate fund of profits out of which a dividend distribution is made, shall be determined as of the date of the *payment* of a dividend. In the absence of such specification, a court of construction must infer that Congress intended that there should be applied the accepted and logical rule of corporation law, that the determination is made as of the time of the *declaration* of the dividend. To adopt the novel and arbitrary rule for which the Government contends, would be to read into the statute something which is not there and which Congress would have put there if it had intended that that rule should apply. Furthermore, to read that rule into the statute would be to attribute to Congress the intent to cause many practical absurdities and to create conflict with good accounting practice and the established rules of corporation and criminal law.

Respectfully submitted,

CHARLES E. HUGHES,
EDWARD CORNELL,
WILLIAM C. BREED,
PAUL ARMITAGE,
HARRISON TWEED,
Amici Curiae.

APPENDIX A.

Section 31 of the Revenue Act of 1916 as amended by the Act of October 3, 1917, reads as follows:

"Sec. 31. (a) That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association or insurance company; which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

Office Supreme Court, U.S.
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OCT 6 1927
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

NO. [redacted] 152

F. H. MASON, Petitioner,

Against

C. F. ROUTZAHN, Collector of Internal Revenue for the Eighteenth District of Ohio, Respondent.

BRIEF SUBMITTED BY LEAVE OF COURT.

JAMES E. MacCLOSKEY, JR.,
Amicus Curiae.

1323 Farmers Bank Building,
Pittsburgh, Pa.

SMITH BROS. CO. INC., LAW PRINTERS, 208-212 GRANT ST., PITTSBURGH, PA.

IN THE

Supreme Court of the United States

NO. 770.

F. H. MASON, Petitioner,

Against

C. F. ROUTZAHN, Collector of Internal Revenue for the Eighteenth District of Ohio, Respondent.

Brief Submitted by Leave of Court.

By JAMES E. MACCLOSKEY, JR., *Amicus Curiae.*

Why did Congress adopt so peculiar a date as August 6th, 1917 in the exempting proviso of Paragraph 31 (b) of the Revenue Act of October 3rd, 1917, which provides,

> "This sub-division shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

The answer to this question, it is submitted, will determine what Congress meant by the word "distribution" as used in this exempting proviso of Section 31 (b) of the Act, and, therefore, what Congress meant by the word "distribution" as used in the first part of Section 31 (b) of the Act.

This brief is filed by me on behalf of fifteen clients who are stockholders of the Harbison-Walker Refractories Company, and who have cases pending in the Courts. Harbison-Walker Refractories Company on August 3rd,

1917 declared a dividend on its common stock, payable on August 25th, 1917, and payable out of the surplus of the Company that had been accumulated prior to March 1st, 1913. Under the Internal Revenue Act of 1916 in effect at the time of the declaration of the said dividend and in effect at the time of the payment of the said dividend, and under the rules and regulations of the Commissioner of Internal Revenue in force both at the time of the said declaration and at the time of the said payment, the said dividend was not taxable as income to the stockholders of the said Company inasmuch as it had been declared out of earnings or profits accrued prior to March 1st, 1913. The Revenue Act of 1916 as amended by the Act of October 3rd, 1917, added a new provision in the law by providing in Section 31 (b):

> "(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out

of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

The question, therefore, before the courts in the said Harbison-Walker Refractories Company cases is: Was this dividend so declared on August 3rd, 1917, but payable on August 25th, 1917 out of earnings or profits accrued prior to March 1st, 1913, a distribution made prior to August 6th, within the proviso of Section 31 (b) of the Act?

THE LEGISLATIVE HISTORY OF THE ACT OF OCTOBER 3RD, 1917, CONCLUSIVELY SHOWS THAT CONGRESS INTENDED THAT A DIVIDEND DECLARED PRIOR TO AUGUST 6TH, 1917, OUT OF 1913 SURPLUS SHOULD NOT BE TAXABLE; AND THAT, THEREFORE, A DISTRIBUTION IS MADE UNDER SECTION 31 (b) OF THE ACT WHEN A DIVIDEND IS DECLARED AND NOT WHEN IT IS PAID.

The legislative history of the Act may, where the meaning of the words used is doubtful, be resorted to as an aid to construction. Surely the Governemnt cannot contend that the meaning of the words in question is not doubtful when it acquiesced in the decision of the case of the *Appeal of A. H. Strange*, 1 U. S. Board of Tax Appeals, 810, which decided that the date of the declaration of a dividend, and not the date of payment, governs its taxable status, and then the Government subsequently withdrew its acquiescence. And moreover, nearly six months after fifteen suits at law had been filed by the stockholders of the Harbison-Walker Refractories Company the Commissioner of Internal Revenue acquiesced in the legal principles therein contended for but subsequently withdrew his acquiescence. Surely the Government must admit that the meaning of the words in question is doubtful when it has reversed itself on at least two occasions.

The legislative history of the Act in question is conclusive on the intent of Congress on account of the peculiar date, August 6th, that has been inserted in the exempting proviso of Section 31 (b) of the Act. Why was this peculiar date, August 6th, adopted? Why was not the date of the passage of the Act adopted? Or why was not January 1st, 1917 adopted, thus consistently making the Act retroactive throughout as of January 1st, 1917? To understand why, it is necessary to review the income tax laws.

Under the first Income Tax Law of 1913 it was decided by the Circuit Court of Appeals in *United States v. Guinzburg,* 278 Fed., 363, that a dividend declared on February 17, 1913, but payable July 1, 1913, was a capital account on March 1, 1913, when the income tax first went into effect and that the dividend was not taxable income for 1913. Following this decision, when corporations distributed the surplus which they had accumulated prior to March 1, 1913, it was contended that the dividends received out of this surplus, even though declared and paid after March 1, 1913, were not taxable as income to the stockholders, but this contention was disputed by the Government, and rightfully, and the Supreme Court of the United States, in *Lynch v. Hornby,* 247 U. S., 339, decided that such dividends so declared and so paid after March 1, 1913, were taxable to the stockholders. However, even before the final decision of the Supreme Court in *Lynch v. Hornby,* Congress, in order to permit corporations to distribute the surplus which they had accumulated prior to March 1, 1913 as dividends that would not be subject to the income tax, provided in the Revenue Act of September 8, 1916, which was in effect until October 3, 1917, that cash dividends are taxable only if paid out of earnings accrued since March 1, 1913. Section 2 (a) of the Act provided:—

"That the terms 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen."

Immediately after this, if a corporation declared a dividend and that dividend was actually paid out of March 1, 1913 surplus, or if the Board of Directors ordered the dividend to be paid out of March 1, 1913 surplus, such a dividend was not taxable at all as income to the stockholders. Rules and regulations were issued by the Treasury Department and the Commissioner of Internal Revenue did not make the slightest effort to discourage corporations from taking full advantage of the law. Montgomery, in his Income Tax Procedure for 1918, says, at page 139:

"The law of September 8, 1916, provides that cash dividends are taxable only if paid out of earnings accrued since March 1, 1913.

"The Treasury Department ruled that cash dividends included in returns for the year 1916, were taxable, and that dividends declared out of earnings accrued prior to March 1, 1913, were not taxable, and no return at all was required as to such dividends. It was, however, held that 'the only manner in which a stockholder can omit from his return of annual net income for the year 1916, all or any part of the dividend received is for him to receive a statement from the company that all or a certain portion of the dividends was declared and paid out of surplus and undivided profits accumulated prior to March 1, 1913, and that the books of the corporation reflect such an amount.'

"The Department made no effort to restrict the payment of dividends out of surplus accrued prior to

March 1, 1913, but very properly required evidence that the corporations were keeping strict account of the disposition of the surplus at that date. This is made quite clear in a further ruling, viz:

> 'In each case where dividends are declared and paid out of surplus and profits earned prior to March 1, 1913, the corporation should specifically inform the stockholders that the dividends were declared and paid out of such surplus and profits, and proper entries must be made on the books of the corporation showing from what surplus or earnings the dividends were paid. It is immaterial to this office whether dividends are paid out of current earnings or surplus acquired prior to March 1, 1913, but for the purpose of the Federal income tax it is necessary that this office be fully advised in a return of annual net income whether or not the dividends received were paid out of surplus earned prior or subsequent to March 1, 1913.' "

Immediately after the passage of this 1916 Act corporations throughout the country declared dividends out of their March 1, 1913, surplus. Printed statements were received with the dividend checks notifying stockholders that the dividend received was declared out of March 1, 1913, surplus, and, therefore, was not taxable. This, of course, was before war was declared with Germany and before there was any thought of the tremendous increase in taxation which took place when excess profit taxes went up as high as 80%, and the tax on individuals up to 73%.

Corporations, under this 1916 Act had a right to so distribute tax free dividends and there was not even any evasion of the law or taking advantage of a technicality. They acted in good faith.

The Revenue Act of 1917, passed on October 3, 1917, changed this situation by declaring in Section 31 (b), that any distribution made to stockholders in 1917 and subsequent years shall be deemed to have been paid from the most recently accumulated undivided profits or surplus. Thus corporations had to declare dividends out of their current earnings or surplus and exhaust the same before they could declare them out of the accumulated March 1, 1913 surplus.

As passed by the House the Bill would have continued to allow corporations to distribute their March 1, 1913 surplus as tax free dividends. However, when it reached the Senate Finance Committee a change was made; and on AUGUST 6, 1917 the bill was reported out of the Finance Committee of the Senate by Senator Simmons, Chairman of the Finance Committee. The bill so reported, contained the following provision, which was the basis of Section 31 (b) of the Act as finally enacted:

> "Provided further that any distribution made to the shareholders of a corporation, joint-stock company, or association, or insurance company, in the year 1917 or subsequent tax years, shall be deemed to have been made from the net income of the year in which such distribution is made," etc. Senate Document 11 and Senate Document 74, 65th Congress, First Session.

Accompanying this Bill, so reported to the Senate, was a report of Senator Simmons, Chairman of the Committee of Finance, Senate Reports, Vol. 1, page 103, 65th Congress, First Session, in which it is stated as follows:

> "The more important amendments so recommended by your Committee are as follows:
>
> Ninth. That dividends declared and paid in the year 1917 or subsequent tax years shall be deemed to have been paid from the net income of the year in which paid or from the most recently accumulated sur-

plus, and shall constitute a part of the annual income of the stockholder for the years in which earned by the concern and the tax to be paid by the shareholders shall be at the rate prescribed by law for such years."

This report of the Finance Committee was published broadcast by the newspapers, by the Corporation Trust Company, by the New York banks and other agencies, through circular letters, and the public for the first time realized that, the Bill being retroactive as of January 1, 1917, all the distributions by corporations in 1917 under the 1916 law, made in good faith, out of the surplus existing on March 1, 1913, would not only be not non-taxable, but on the contrary they would be subject to rates of taxation never dreamed of in the history of the United States. A storm of protests arose and many protests were filed with the Conference Committee against the adoption of this report of the Senate Committee, especially the retroactive feature of making taxable these dividends declared in good faith out of March 1, 1913 surplus, when the law and the rules and regulations provided that they were not taxable. Among others protesting was Robert H. Montgomery, an attorney-at-law, a certified public accountant, an ex-President of the American Association of Public Accountants and Assistant Professor of Accounting at Columbia University and a well known authority on income tax procedure. In his book, "Income Tax Procedure, 1918," he says, at page 151:

> "The author, on behalf of clients, submitted the following memorandum to members of the *Conference Committee*:
>
> > 'Under the law of September 8, 1916, dividends declared out of surplus accrued prior to March 1, 1913, are not taxable in the hands of the recipients. The Treasury Department has

ruled that where directors specifically state that particular dividends are applicable to surplus accrued prior to March 1, 1913, and are so charged on the books, the recipients of such dividends are not liable for any tax thereon.

The pending revenue bill provides that all dividends must be charged against most recently accrued earnings, and further provides that this method applies to all dividends declared after January 1, 1917. If no change is made this will work extreme hardship to many stockholders of closely held corporations where extraordinary dividends have been declared during 1917 out of surplus accrued prior to March 1, 1913. In most cases such dividends have been paid in stock, and no change in actual condition has taken place. That is, a corporation with a small capital and a large surplus changes over to a large capital and a small surplus. No cash has been paid out; the stockholders have received nothing of value as their equity has not changed.

If the pending bill becomes a law and an attempt is made to upset the action of the directors and hold that such dividends are applicable to the earnings of 1917 or 1916, and taxes are assessed accordingly, grave injustice will result, and certain stockholders who in fact have received nothing valuable either from an accounting or a market point of view will have assessed against them enormous taxes which many will be unable to pay. The Government cannot claim that such stockholders are in a position of their own creation. On the contrary, the Government itself, by the law of 1916 and the regulations of the Treasury Department relating thereto, has directly said to such corporations and such stock-

holders, 'You may specify that dividends are applicable to surplus accrued prior to March 1, 1913, and subject to such surplus being an actual surplus at that date no income tax will be levied thereon.'

In other words the pending law is a clear violation of the Government's own policy and to penalize stockholders who innocently followed the guidance of the Government would be extremely unjust and inequitable and, while it might result in the immediate collection of a certain amount of tax, never could be defended and could hardly be expected to be sustained by the courts.

The suggestion is made that the provision as to the designation of surplus out of which dividends are declared be made operative as of the date the revenue bill becomes a law or at an early date thereafter.

The provision is not one which commends itself to the writer, but if not made retroactive no one can complain of lack of notice from the Government that the law of 1916 has been subjected to a radical change.'"

As a result of these protests, the Conference Committee, on October 2, 1917, the day before the Act was finally approved, recommended the exact language of Section 31 (b), as finally passed, containing the exempting proviso with its peculiar date of AUGUST 6, 1917, which is so clarifying to the situation and shows so conclusively that Congress intended that if a corporation in good faith acted prior to August 6, 1917, by declaring dividends out of the March 1, 1913, surplus, such dividends should not be taxable. The exempting proviso is as follows:

"This subdivision shall not apply to any distribution made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913."

Moreover, Senator Simmons, in the debate on the Bill in the Senate on October 2nd, 1917, the day it was passed, page 7615, Congressional Record, 65th Congress, First Session, further conclusively showed the intent of Congress by speaking as follows:

"Under existing law and in the House Bill the accumulated surplus of corporations when distributed, whether in cash or in stock, become subject to surtax of the stockholder receiving it unless the surplus thus distributed was accumulated prior to March 1, 1916 (1913), the date of the adoption of the income-tax amendment to the Constitution. Surplus acquired before that date is not and cannot be subject to an income tax of any kind. In this condition of the law it was clearly to the interest of the corporation to distribute its surplus accumulated before 1913 instead of that more recently accumulated.

"In order to be just to the corporations and at the same time to encourage them to distribute their annual earnings your Committee reported to the Senate and the Senate adopted an amendment providing that the surplus when distributed shall be taxed to the distribution (distributee) at the rate prescribed by law for the year in which they were earned, but also provided that any distribution of surplus made in 1917 or subsequent tax years should be deemed to have been made from the most recently accumulated undivided profits, thereby making it necessary for the corporation to distribute its surplus earned since March 1, 1913, before that earned prior to that time. (Interuption).

"The Conferees agreed to these amendments but added an amendment to the effect that the later amendment—that is to say, the one requiring the distribution to be made from the most recently acquired surplus—should not apply to any distribution made prior to

AUGUST 1 (6), 1917, out of earnings accrued prior to March 1, 1913."

Why was the date, August 6th, taken? We submit that it was not an arbitrary date, but it was the date on which the Senate Finance Committee reported the bill to the Senate, accompanied by its report, calling attention of the taxpayers in the United States to the change in the law. Montgomery, in his 1918 Income Tax Procedure, states, at page 153:

> "The date selected, viz: August 6, 1917, was the date on which the Senate Finance Committee reported the Revenue Bill as amended to the Senate. As reported, the bill indicated the intention to compel the distribution of all earnings subsequent to March 1, 1913, before the surplus at that date could be distributed. This was sufficient notice of a radical change in the 1916 law, and directors who declared dividends after August 6, 1917, were charged with a knowledge that the 1916 law would be amended."

Under this state of facts, therefore, if a corporation in good faith declared a dividend on August 3rd, 1917, was it not clearly a distribution made prior to August 6th, within the intention of Congress? The primary purpose of taking the date of August 6th was to leave undisturbed the actions of corporations that had acted in good faith prior to August 6th, but to tax the stockholders of corporations that had declared dividends out of their March 1, 1913, surplus, after the Senate Finance Committee had made its report. Senator Simmons states: "In order to be just to the corporations" conferees added the amendment to the effect that 31 (b) should not apply to any distribution made prior to August 6th. Surely it would not be *just* to corporations to make its stockholders taxable on a dividend so declared, and as we contend, "distributed" prior to August 6th, 1917.

If, therefore, a "distribution made" under the exempting proviso of 31 (b) occurs when the dividend is declared, it necessarily follows that under the first part of Section 31 (b) a distribution is made when the dividend is declared and not when it is paid.

* * * * * * * * *

The legislative history of the Income Tax Act also disposes of a point strongly urged by the Government in the case at bar. Section 31 (a) of the Act of 1917 limits the meaning of the word "dividends" not by defining the term, but by providing

> "That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen," etc.

The Government emphasizes the words "made or ordered to be made" and absolutely ignores the essential qualifying phrase, "out of its earnings and profits accrued since March 1, 1913." It then argued that inasmuch as the phrase "ordered to be made" is omitted from Section 31 (b), Congress had a deep seated purpose in this omission.

It is submitted that Section 31 (a) was literally taken from the Act of 1916, while Section 31 (b) made its first appearance in the Act of October, 1917. Section 31 (a) was, as it stated, literally taken from the Act of 1916 and its purpose, as we have above stated, was to permit corporations to distribute their accumulated March 1, 1913, surplus in non-taxable dividends. As above explained, under the first Revenue Law of 1913, *Guinzburg v. United States* held that a dividend declared before March 1st, 1913, but payable after March 1st, 1913, was not income that, under the Constitution, could be subjected to an income tax;

then the corporations attempted to distribute all their accumulated March 1st, 1913 surplus and stockholders contended that inasmuch as that surplus had been accumulated before March 1st, 1913, on its distribution by the declaration of dividends after March 1st, 1913, they were not taxable. Various suits arose and finally Congress, in the Revenue Act of 1916, put to rest the matter, not by defining dividends but by limiting taxable dividends to those distributed from surplus earned since March 1, 1913. Section 2 (a) of the Act of 1916 provided:

> "That the term 'dividends,' as used in this title, shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen."

These are the words that changed the law completely and permitted corporations to distribute their dividends out of March 1st, 1913 surplus. If (a) a corporation had nothing but March 1st, 1913 surplus at the time of distribution such dividend would not be "any distribution made * * * out of its earnings or profits accrued since March 1, 1913"; or (b) if a corporation having both current earnings and March 1st, 1913 surplus declared a dividend and "ordered" the distribution made out of March 1st, 1913 surplus, then such a dividend would not be a "distribution * * * ordered to be made by a corporation * * * out of its earnings or surplus accrued since March 1st, 1913"; therefore neither dividend would be taxable income to the stockholders.

The words of the 1917 Act in Section 31 (a) are absolutely identical with this important provision of the 1916 Act. This Section 31 (a), which the Government calls a definition, but which we submit is a limitation

of the meaning of the word "dividends," which originated in the 1916 law, was continued in the 1917 law to provide for the corporations that had made distributions prior to August 6th, 1917, and also for the cases where a corporation, even after August 6th, 1917, exhausted its current earnings and resorted to the distribution of dividends out of the March 1st, 1913 surplus. That this was the purpose and meaning of Section 2 (a) of the Revenue Act of 1916 and of Section 31 (a) of the Revenue Act of 1917 was shown by the remarks of Mr. Justice Pitney in the case of *Lynch v. Hornby,* 247 U. S., 339, where, at page 345, he says:

> "In the more recent income tax acts, provisions have been inserted for the purpose of excluding from the effect of the tax any dividends declared out of earnings or profits that accrued prior to March 1st, 1913. This *originated* with the Act of September 8th, 1916, and has been *continued* in the Act of October 3rd, 1917." (Italics ours.)

The note by the Supreme Court is as follows:

> "In Act of September 8, 1916 (Chap. 463, 39 Stat. at L. 756, 757, Comp. Stat. 1916 §6336a, 6336b), which took the place of the Act of 1913, the substance of what we have quoted from ¶ B of the 1913 Act was embodied in §2 (a), but with this proviso: 'Provided, that the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * *out of its earnings or profits accrued since March first, nineteen hundred and thirteen,* and payable to its shareholders, whether in cash or in stock of the corporation,' etc. And by the Act of October 3, 1917 (chap. 63, 40 Stat. at L. 300, 329, 337, 338), §2 (a) of the 1916 Act was amended by being repeated without the proviso (p. 329), while the proviso was inserted as a new section—31 (a)—

and to it was added a subsection, (b), as follows:" The Supreme Court then copies Section 31 (b) of the Act of 1917. (The italics are by the Supreme Court.)

We submit, therefore, that the words "made or ordered to be made," are wrongly interpreted by the Government. They positively do not refer to two periods of time, as the Government contends, but they clearly refer to two different sets of facts; namely, (a) if the corporation had only March 1st, 1913 surplus, a distribution out of it was not a taxable dividend, or (b) if a corporation having current earnings and March 1st, 1913 surplus, "ordered" the distribution to be made out of the 1913 surplus, it was not a taxable dividend. This clearly refers to two states of fact—and not to two periods of time, as the Government is contending by trying to make a distinction between the date of the declaration of a dividend and the time of the payment of a dividend. Granting that this was the intent of Congress in limiting the word "dividends" as used in Section 31 (a), (and Justice Pitney says that that was the intent of Congress) then there would be no object or purpose in putting the words "ordered to be made" in Section 31 (b), because the primary purpose of Section 31 (b) was to deprive corporations of the power of "ordering" distributions to be made out of any particular surplus. It required distribution subsequent to January 1, 1917, to be made out of current earnings, except in the case of distributions falling within the proviso.

* * * * * * * * *

In conclusion, it is submitted that a mere statement of the facts in chronological order leading up to the enactment of this proviso shows conclusively that Congress intended that a dividend declared before August 6th, 1917 out of March 1st, 1913 surplus, was a "distribution made before August 6th, 1917"; that Congress, by adopting the

date August 6th, 1917, did intend to keep faith with a corporation which, bona fide, had taken action by declaring a dividend before August 6th, 1917, even though such dividend was payable after this date. Briefly, the facts in chronological order are as follows: (a) The Act of 1916, in effect until October 3rd, 1917, which expressly permitted a corporation to declare non-taxable dividends out of surplus existing as of March 1st, 1913; (b) The introduction of the Bill which finally became the Act of October 3rd, 1917, which Bill permitted a corporation to continue to declare such non-taxable dividends; (c) The report made public on AUGUST 6TH, 1917, of the Finance Committee, setting forth its recommendations to prohibit this practice and to compel dividends to be paid out of current earnings; (d) The protest filed against interfering with the bona fide action of corporations already taken during the year 1917 in declaring such non-taxable dividends; (e) The specific request or suggestion by Montgomery, that the proposed change in the law should be made operative as of the date of the passage of the Bill; (f) The insertion in the Bill, on October 2nd, 1917, the day of its passage, of this significant date, AUGUST 6TH, 1917; (g) The remarks by Senator Simmons, Chairman of the Finance Committee, on October 2nd, 1917, that "in order to be just to the corporations" an amendment was adopted making dividends payable out of current earnings, but that this amendment should not apply to any distribution made prior to AUGUST 6TH, 1917, out of earnings accrued prior to March 1st, 1913.

Surely Congress intended that in order "to be just to the corporation" its action should be judged as of the date when it declared a dividend, and not when it paid it.

Respectfully submitted,

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Amicus Curiae.

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No. 152

IN THE

Supreme Court of the United States

OCTOBER TERM, 1927.

F. H. MASON,

Petitioner,

against

C. F. ROUTZAHN, Collector of Internal Revenue for the Eighteenth District of Ohio,

Respondent.

CHARLES E. HUGHES,
HARRISON TWEED,
of Counsel.

S. M. JETT,
HORACE ANDREWS,
Counsel for Petitioner.

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Respondent.

REPLY BRIEF OF PETITIONER

The first point in our main brief was that the Circuit Court of Appeals erred in holding that the earnings for 1917, although shown to have been made after the dividend dates, may be treated as the source of payment for the purposes of fixing the tax rates under Section 31-b. The government does not contest the correctness of this position, stating that it feels "unable to urge this court to affirm that decision" (brief for the Respondent, p. 8). It would seem, therefore, that it is unnecessary to say anything more on this point.

We do, however, wish to call attention to the fact that the brief for the government suggests that in *Edwards* v. *Douglas* this Court considered the suggestion that where a corporation cannot accurately ascertain

the amount of its earnings between the first of the year and the date of the dividend distribution it is proper to determine them by pro-rating to that period the earnings for the entire year. We do not concur in this suggestion. The question was neither raised, argued nor reserved in *Edwards* v. *Douglas;* neither is it material in the present case, where it is affirmatively shown that there were no 1917 earnings up to the dividend dates.

Therefore, the only question of interpretation which remains is whether in determining the source of a dividend the earnings existing at the time of the declaration of the dividend are to be looked to or whether the earnings made after the declaration of the dividend and before its payment are to be included as a part of the fund distributed.

The government in its brief has not even endeavored to answer the main propositions upon which we rely. These propositions are:

First. That the statute does not expressly specify as of what date the "most recently accumulated undivided profits or surplus" are to be determined. This proposition is stated in our main brief at page 19 and at page 5 of the brief submitted by Charles E. Hughes, Esq., et al. as amici curiae.

Second. The proposition that the failure of the statute to specify as of what date the most recently accumulated undivided profits or surplus are to be determined is conclusive that it intended to leave the selection of that date just where it found it, and that the selection should be made in accordance with the rules of corporate and criminal law and sound corporate practice. This proposition is stated at page 26 of our

main brief and at page 7 of the brief of the amici curiae.

The argument of the government seems to boil down to this: That the requirement that the earnings up to the date of the payment of the dividend shall be included in determining the source of the dividend, is to be read into the statute, because of the use of the words "distribution made" in conjunction with the words "most recently accumulated undivided profits or surplus." The government says that the words "distribution made" mean "dividend paid," and that when Congress said that a "distribution shall be deemed to have been made from the most recently accumulated undivided profits or surplus," it referred to the earnings existing when the dividend was paid.

It should be noted that this is a very narrow and technical argument. It seeks by implication to substitute for the fund which is legally, practically and customarily recognized as the source of a dividend a totally different fund—one which is not in existence when the dividend is declared. It is proper, therefore, to consider whether there is anything in the situation to indicate that Congress intended so narrow a meaning and a purpose so abnormal. If it should appear that to give those words that narrow meaning throughout the Section would defeat some of the obvious and avowed purposes of Congress and that in certain parts of the Section they must, in order to avoid absurdity, be interpreted otherwise, then there is no reason why when used to define the source of a dividend they should be given that unnatural and narrow meaning.

In enacting Section 31-b Congress had in mind four main purposes with respect to which the question of

what constitutes a dividend distribution was material.

(1) To define the class of dividends embraced within the purview of the statute.

(2) To designate what earnings are deemed to have been distributed by a dividend.

(3) To permit the distribution exempt from tax of any earnings accrued before March 1, 1913, after the distribution of all earnings subsequently accumulated.

(4) To exclude from the provisions of Section 31-b a distribution made prior to August 6, 1917, out of earnings accrued before March 1, 1913.

Can these purposes be given effect by interpreting the words "distribution made" throughout this section as meaning "dividend paid"? It will facilitate the answering of this question to consider the effectuation of these purposes in the reverse order to that in which they have been stated.

(1) If we give the words "distribution made" the meaning "dividend paid," in the proviso at the end of Section 31-b the purpose of Congress in adding that proviso would be defeated. The purpose of this proviso was, as stated in our main brief, to keep faith with the stockholders of a corporation, the directors of which in reliance upon the existing law and before they had notice of any proposed change, had expressly declared a dividend to be payable out of a surplus existing on March 1, 1913. (See brief of Petitioner, pages 24-25; brief filed by Charles E. Hughes, Esq., et als., page 14; and brief filed by James E. MacCloskey, Jr.)

The government practically admits that for the effectuation of this purpose the words "distribution made" can not be given the meaning dividend paid. In

its brief it does not attempt to claim that to exclude from the proviso a dividend declared before August 6 and paid afterwards would accord with the intention of Congress. All that it can suggest is that a corporation which had before August 6 declared a dividend expressly payable out of earnings accrued before March 1, 1913, and had made that dividend payable at a date *after* August 6, 1917, might protect its stockholders from the high 1917 rates by rescinding the dividend. But if the statute is interpreted so as to compel a revocation of the dividend the purpose of Congress is completely defeated. What Congress intended was that such a dividend should be protected and preserved by the proviso; not nullified thereby. To say that the dividend can be revoked by a corporation would not effect this congressional intent but on the contrary destroy it. We pass without comment but we do not acquiesce in the suggestion that a dividend legally declared could be revoked under such circumstances over objection of the stockholders.

(2) If the word "distribution" as used in the clause permitting the distribution of earnings accrued before March 1, 1913, after the distribution of all earnings subsequently accumulated be limited to the meaning "dividend paid" the provision becomes unworkable. The condition precedent to a distribution of tax free profits accrued prior to March 1, 1913, is that it occur after the distribution of profits accrued *since* March 1, 1913, has been made. If the declaration of such profits accrued after March 1, 1913, only becomes effective on the date of the payment and so attaches to and distributes the profits accrued intermediate to the declaration and payment date, then any attempted distribution of such profits accrued *since* March 1, 1913,

is ineffective to pay out all such earnings in a case where the corporation is a going concern and makes earnings after the declaration date. If the directors acting in good faith seek to declare out all of the subsequent profits shown by the corporate books at the date of the declaration and if the dividend attaches to profits subsequent thereto and up to the payment date, and operates to pay them out, the "declaration" would leave in the coffers of the corporation a residuum of earnings and profits accrued since March 1, 1913, undistributed. Therefore the condition precedent to a distribution of March 1, 1913, profits would not be complied with. The directors of the corporation, therefore, although endeavoring by all means within their power to denude the corporation of its profits accrued since March 1, 1913, so as to comply with the requirements of the statute as a prerequisite to the declaration of the March 1, 1913, earnings, would be helpless because by the terms of the statute their declaration would be forced to embrace profits accrued subsequent to the declaration date, thus rendering the declaration defective by the amount of such subsequent profits. Nor could this condition be cured by the directors making another distribution of this residuum of profits because that second distribution would fall likewise within the terms of statute and be subject to the same infirmity. So the directors of a going corporation making profits would always be confronted with an irreducible residuum accrued after March 1, 1913, that they were precluded from paying out and so could never comply with the statute permitting a distribution of the March 1, 1913, profits.

(3) If the words "distribution made" be given the meaning, *dividend paid*, in the clause which says what earnings are deemed to have been distributed by a

dividend, there is substituted for the accepted rule laid down by the principles of corporation and criminal law an arbitrary and artificial rule whereby the source of a dividend is deemed to be a fund which did not exist when the dividend was declared. There is nothing in the words which Congress used to indicate that it intended to create that unnatural and abnormal situation.

We think that what we have said amounts to a demonstration that the Government's argument that this abnormal and unnatural rule must be read into the statute, simply because Congress has used the words "distribution made," can not be maintained. These words can not be given the meaning "dividend paid" in at least two of the places in which they have been used. Therefore there is *no necessity* for giving the words that meaning, when Congress used them in designating what earnings are deemed to have been distributed by a dividend. There is *no propriety* in giving them that meaning, because to do so is to produce an abnormal and illogical result.

(4) The Solicitor General finally makes the claim that our argument, if carried to its logical conclusion, would lead to the result that a dividend declared in 1916, but paid in 1917, is not covered by the provisions of Sec. 31 (b), and is therefore taxable at the high 1917 rates no matter what its source.

The Government says that the purpose of Congress in defining the class of dividends to be embraced within the purview of Section 31 (b) will be defeated unless the words "distribution made," as used in the first sentence, be given the meaning "dividend paid." It suggests that to exclude from the provisions of Section 31 (b) a dividend declared in 1916 but paid in 1917,

would be so arbitrary and unreasonable as to clearly be contrary to the congressional intent. We assert that such a dividend should be included as subject to the provisions of Section 31 (b). But is this in any way inconsistent with our position that in the clause which designates what earnings are deemed to have been distributed by a dividend the words "distribution made" should not be given the meaning of "dividend paid"?

We are at a loss to understand why any of the manifest intentions of Congress in various parts of this section should be defeated by giving to particular words or phrases used throughout this section a limited meaning, where such words or phrases are sufficiently broad or flexible to permit the accomplishment of all of these purposes. The phrase "distribution made" is sufficiently general and flexible to permit the effectuation of each and all of the purposes of Congress.

The argument of the taxpayer is that in interpreting Section 31 (b) the courts should do something more than consult the dictionary and a grammar and should endeavor to give a logical and reasonable effect to the words used by Congress in the light of its obvious and admitted purposes.

There is no necessity to pervert the meaning of the words "distribution made." All that is required is that they be given their true significance.

In the nature of things a dividend distribution is neither exclusively the declaration of a dividend nor the payment of a dividend. A dividend distribution has two distinct phases. First, it is the deliberation of the Board of Directors and the resolution whereby a part of the assets of the corporation are appropriated and set aside as the property of the stockholders. This is the substantial part of the procedure, but it is not the

entire transaction. There remains the actual payment to the stockholders, which in practice takes place as a separate act at a later date. A reference to a dividend distribution connotes the entire transaction, beginning with the meeting of the Board of Directors and ending with the receipt of the dividend checks by the stockholders. Nevertheless, when used in certain contexts and with certain purposes in mind, the phrase may properly be deemed to refer to one part or the other of the transaction.

In the various places in which the phrase "distribution made" is used in Section 31 (b), Congress had four separate purposes in mind and naturally enough was regarding the distribution from the standpoint of the accomplishment of each separate purpose. When in the proviso its purpose was to protect the stockholders of corporations which, in declaring dividends out of earnings accrued prior to March 1st, were relying upon the then existing law, and had received no notice of the proposed change in the law, it must have had in mind the action of the Board of Directors in declaring the dividend, because for the accomplishment of its purpose that constituted the significant part of the procedure incidental to a dividend distribution. Therefore, it is only reasonable to assume that in referring to a dividend distribution made prior to August 6, 1917, Congress meant a dividend which had been *declared* before that date.

Likewise, when permitting the distribution of the profits accrued before March 1, 1913, Congress did not intend to attach a condition precedent that would nullify this privilege, yet to make the distributions effective against the earnings up *to the date of pay-*

ment of the dividend would destroy this privilege, and render those provisions unworkable.

Similarly, when in laying down a conclusive presumption whereby earnings should be deemed to have been distributed in the inverse order of their accumulation and thereby eliminating the discretion of the Board of Directors in specifying what earnings were distributed, Congress must have had in mind the part of the transaction consisting of the action of the Board of Directors. One reason is that that is the time as of which the Board of Directors would have exercised that discretion and another and more important reason is that that is the time as of which, according to established rules of law and accounting, the source of the dividend is fixed. Therefore, as there used, the words "distribution made" mean "dividend declared."

When the purpose of Congress was to provide what dividends should be governed by the provisions of Section 31 (b), it naturally had in mind not the time when the Board of Directors acted but the time when the dividend was physically paid, because it was the physical payment of the dividend which was material for the purposes of the application of this section. Of course, Congress was dealing with payments that were made in the specified tax years, and this is shown by the express provision making the distribution income in the year in which received by the stockholder. The section fixed the rates for the taxation of dividends received by stockholders and its application should depend not upon the time that the dividend was declared but upon the time when it was paid. This is made clear by the words which Congress expressly used. It said, "any distribution made to the shareholders of a corporation in the year 1917." This is a clear indi-

cation of what it had in mind and is in clear contradistinction to the thought which prevailed in the other parts of the Section when the significant factor was the action of the Board of Directors.

The difficulties which beset the Government's argument arise entirely from its attempt to place upon the broad and general phrase "distribution made" a narrow and inflexible meaning. The Solicitor takes the position that there are only two constructions that can be given to this phrase: it either means "dividend paid" or "dividend declared." Starting from either of these alternatives argument ends in irreconcilable inconsistency. The dilemmas that the Solicitor raises are entirely of his own making and do not inhere either in the statute or in its phraseology.

There are two or three collateral and minor matters mentioned in the Government's brief to which it is necessary to refer:

(1) The Solicitor's reference to Section 58 of the New York stock corporation law is not happy. A reading of this section discloses that the words "distributions made" are used in it in no narrow or limited meaning but embrace the declaration as well as the physical payment of the dividend. The statute quoted helps rather than hurts the taxpayer's position.

(2) The argument of the Government, made at p. 21 of its brief, that the purpose of the statute will be best served by the interpretation which it suggests need not be discussed further than to say that it begs the entire question. It is suggested that there is no reason why one stockholder who receives a dividend on June 30, 1917, should pay the law of 1917 rate if the dividend was declared on June 30th, but the law of 1916 rate

if it was declared on January 2nd. In truth there is every reason in the world for the distinction. The purpose of Congress was that dividends should be taxed at the rate applicable to the year in which the earnings distributed by them were accumulated by the corporation. Every one knows offhand and without analysis that a dividend declared on January 2, 1917, must constitute a distribution of earnings accumulated in 1916 or prior years.

(3) At page 23 the Government's brief says: "From the beginning the Treasury Department construed the statute to mean that the distribution is made when the dividend is paid." This statement does not seem to be supported by the following reference to the various actions of the Treasury Department and its Solicitor under this section.

The reference is to Regulation 33 (Revised), promulgated on January 3, 1918. It is true that this section places the date of the dividend payment as the time of the determination of the current earnings to which it applies; yet in the same paragraph it lays down a different rule for the proviso. It is here stated (italics ours):

> "The provisions of section 31, subdivision (b) do not apply to distributions made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913; that is to say, that such distributions will not be deemed to have been made out of the most recently accumulated surplus or profits, if *at the time of distribution*, before August 6, 1917, they were *specifically declared* to be out of accumulations prior to March 1, 1913."

This position that a distribution becomes effective at the date of the declaration was in exact accord with

the opinion expressed by Commissioner Gates on November 30, 1915. He wrote to the Corporation Trust Company a letter (see the company's Income Tax Service, 1916, at par 66), in which he said:

> "that a surplus representing the net earnings of a corporation, regardless of the period during which earned, is subject to the income tax as dividends *when distributed, whether by declaration of dividends or otherwise*, if the distribution was authorized on or after March 1, 1913." (Italics ours.)

The question was presented to the Board of Tax Appeals in the case of A. H. Stange, and in March, 1925, that Board decided the Stange case, holding that the words "distribution made" in Section 31 (b) meant the declaration of a dividend, as distinguished from its payment. On July 27, 1925, the Commissioner published his acquiescence in this decision, thus establishing this construction as one recognized by the Bureau. This recognition was reported early in the year 1926, at the time of the publication of Cumulative Bulletin CB IV—2, p. 6. This acquiescence was not withdrawn until eight months thereafter, on March 22, 1926, or approximately one year after the decision of the Stange case. Internal Revenue Bulletin V-12, p. 1.

Furthermore, on the precise point involved in this case, namely, whether the date of declaration or the date of payment should govern in determining the source of a dividend, there has been no continuity of practice. It is true that for a number of years the Regulations provided that the date of payment should govern. Nevertheless, in this case and in other cases, it was contended by the Treasury Department that neither the date of payment nor the date of declaration should govern, but that all of the earnings during the

entire year should be deemed the source of the dividend.

(See *U. S.* v. *Phillips*, pending before the United States Circuit Court of Appeals for the Third Circuit. See also the Kirby case in the Court of Claims, now on writ of certiorari to this Court.)

Immediately after the decision of the Circuit Court of Appeals in the present case, a ruling was handed down by the Treasury Department reversing its former ruling and declaring that the rule thereafter would be that the earnings of the entire year would be regarded as the source of the dividend.

In view of this record it is difficult to follow the Government's argument on any uniform practice of the Treasury Department or its representatives. Whatever this Court may decide, it must, *ex necessite*, be inconsistent with the position which the Treasury Department has taken at some time or other.

Respectfully submitted,

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J. D. Mason,

Petitioner,

vs.

C. F. Bouvaird, Collector of Internal Revenue,

Respondent.

BRIEF FOR PLAINTIFF IN ERROR.

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No. 770.

In the Supreme Court of the United States

F. H. Mason,

Petitioner,

vs.

C. F. Routzahn, Collector of Internal Revenue,

Respondent.

BRIEF FOR PLAINTIFF IN ERROR.

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Revenue Act of 1917, Sections 1 and 2 24

SUMMARY OF ARGUMENT.

Point I. As used in Section 31 (b) of the 1917 Act, "most recently accumulated undivided profits or surplus" meant those which had been earned by the corporation before and up to the dividend distribution, and did not include those coming into existence during the same year but after the distribution. (p. 8)

Point II. For the purpose of determining from what year's profits or surplus a dividend distribution is deemed to have been made, the dividend declaration constitutes the "distribution" within the intent and meaning of Section 31 (b). (p. 19)

No. 770.

In the Supreme Court of the United States

F. H. Mason,
Petitioner,

vs.

C. F. Routzahn, Collector of
Internal Revenue,
Respondent.

BRIEF FOR PLAINTIFF IN ERROR.

I.

This case comes before this Court on a writ of certiorari to review the decision of the Circuit Court of Appeals for the Sixth Circuit, entered June 30, 1926, reversing the judgment of the District Court. The decision of the District Court is reported in *Mason v. Routzahn*, 8 Fed. (2nd) 56, that of the Circuit Court of Appeals in *Routzahn v. Mason*, 13 Fed. (2nd) 702.

II.

The case involves the construction of Section 31-b of the Revenue Act of 1917, which is as follows:

"Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were

paid

accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein contained shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

The judgment of the District Court was entered September 18, 1925 (R. p. 20). The opinion of that Court is fully set out (R. p. 16). The judgment of the Circuit Court of Appeals, reversing the District Court, was filed June 30, 1926 (R. p. 26). The conclusion and determination of that Court are shown in its opinion (R. p. 26). Petition for rehearing was overruled on August 7, 1926 (R. p. 29).

The Circuit Court by its rulings and decision (R. pp. 26, 27, 28) misconstrued and misapplied Section 31-b of the Act of 1917, as hereinafter indicated.

III.

STATEMENT OF THE CASE.

This suit was brought by Mason to recover the sum of $12,458.60 of income taxes wrongfully exacted from him on account of corporate dividends received during the year 1917 from The B. F. Goodrich Company, which were declared and paid as follows:

Stock	Date Declared	Date Paid	Amount Received
Common	October 25, 1916	Feb. 15, 1917	$22,781.00
Preferred	January 24, 1917	Apr. 2, 1917	17,473.75
Common	January 24, 1917	May 15, 1917	22,781.00
Preferred	January 24, 1917	Jul. 2, 1917	17,473.75
		Total—	$80,509.50

These dividends were reported as taxable at the 1916 rates. Subsequently the Commissioner of Internal Revenue determined that such dividends were taxable at the 1917 rates, and thereafter assessed against Mason, and on demand Mason paid to Routzahn as Collector, said additional taxes in the sum of $12,458.60. Mason filed a claim for refund of the amount so paid, which was rejected, and this action was brought to recover the amount of such payment with interest (R. pp. 1, 2, 3, 4).

The answer, while admitting that Routzahn was at all times named in the petition the Collector of Internal Revenue, denied all other allegations of the petition (R. p. 15). The parties waived a jury and the case was tried to the District Judge on an agreed statement of facts (R. pp. 6-15).

It appeared from the agreed facts that up to July 2, 1917, The B. F. Goodrich Company had no undivided profits or surplus for the year 1917 from which dividend distributions could be made. It was therefore claimed by Mason that on any theory of the case the dividends in question received by him from The B. F. Goodrich Company were taxable only at the 1916 rate.

In due time the District Court entered its judgment in favor of Mason for the amount claimed in the petition, with interest thereon, to-wit, the total sum of $14,202.72 (R. p. 20). As shown by the opinion (R. pp. 16-20), the District Judge found and held that in determining from what year's undivided profits or surplus a dividend distribution should be deemed to have been made, the *dividend declaration* constituted the "distribution" to the stockholders within the meaning of Section 31-b of the Act of 1917; that upon the agreed facts The B. F. Goodrich Company had no profits or surplus for the year 1917 before and up to January 24, 1917, the date of the last declaration of dividends, and that the dividend distributions were from

the undivided profits or surplus of the Company existing in the year 1916,—by reason of which, and because of his conclusions of law, judgment was entered for the plaintiff.

The Collector took the case to the Circuit Court of Appeals on writ of error. That Court reversed the judgment of the District Court and remanded the cause with directions to enter judgment for Routzahn (R. p. 26).

In deciding this case the Circuit Court of Appeals misconstrued the decision of this Court in *Edwards v. Douglas*, 269 U. S. 204, and based its decision mainly upon a single paragraph found in the opinion of Mr. Justice Brandeis,—overlooking, we believe, the central ideas and intention of this Court in that decision.

The Circuit Court of Appeals reached the conclusion that the dividend declaration did not constitute a "distribution" within the meaning of the 1917 Act (R. p. 27). The exact statements of the Court are hereinafter quoted on page 19.

The Circuit Court of Appeals also determined that the phrase "most recently accumulated undivided profits or surplus" did not mean those earned *before and up to the time of the dividend distribution*, but meant those finally ascertained and entered as the profits for the entire year (R. p. 28). We quote in full the language of the Court on page 9.

Thereupon the Court reversed the judgment of the District Court and directed judgment to be entered in favor of Routzahn.

IV.

The decision of the Circuit Court of Appeals is erroneous in two important respects, each of which is contrary to principle and to the provisions and meaning of Section 31-b of the Act of 1917:

1. It held that, for the purpose of determining from what year's profits a dividend distribution should be deemed to have been made, the "most recently accumulated undivided profits or surplus," are "those which are *finally ascertained and entered* as the profits for the entire year during which dividends are paid," and are to be "judged from the end of the fiscal year during which the income was received," even though up to the time of the dividend distributions there were no profits for that year.

2. It held that the *dividend declaration* does not constitute a "distribution" by a corporation to its stockholders within the meaning of Section 31-b.

ARGUMENT.

This case involves the construction and application of Section 31-b of the Revenue Act of 1917 relative to two important questions:

1. What are the "most recently accumulated undivided profits or surplus"? Are they "those which are finally ascertained and entered as the profits of the entire year during which dividends are paid," to be "judged from the end of the fiscal year during which the income was received," even though they did not come into existence until after the distribution by the corporation? Or, are they those which were accumulated before and up to the time of the distribution, including current earnings of the corporation before and up to said date?

2. What constitutes the distribution which, by Section 31-b is deemed to have been made from the most recently accumulated profits or surplus? Is it the dividend declaration or is it the dividend payment?

In considering these questions, the purpose of Congress in enacting Section 31-b and adopting its various provisions is of primary importance. The country was faced with war conditions, which required that vast additional sums become available to meet the necessary outlays, and Congress had determined that the income taxes must be very greatly increased. It doubled the normal tax and increased the surtax on graduated scales up to sixty-three per cent., so that incomes in general were to be thenceforward taxed at these greatly increased rates.

But to prevent inequalities and great injustice in the taxation of corporate dividends, Congress determined to make a modification as to taxation of dividends.

We need not elaborate this situation because it is found vividly set out in the decision of this Court in

Edwards vs. Douglas, 269 U. S. 204. The provision for the special modification which Congress determined upon is made in Section 31-b of the Act. The purpose of Congress in adopting the particular provisions of this section are specifically stated in the opinion of Mr. Justice Brandeis in *Edwards vs. Douglas*, pages 216-17:

> "Its general aim was clearly to make the dividend, in whatever year paid, bear the tax rate of the year in which the profits of which it was a distribution had been earned."

The special aim was to make the "war profits pay the high war taxes." To accomplish this purpose it was necessary to provide against postponement of distribution of the most recent earnings, which would pay the highest rate, by declaration of dividends from surpluses of earlier years, as to which there would be low tax rates.

It was essential therefore, that, instead of allowing the directors of corporations to determine and declare what years' surpluses were being distributed, a conclusive presumption should be substituted for the discretion of the directors in this respect. Congress therefore provided that

> "*Any distribution* made to the shareholders • • • shall be deemed to have been made from the *most recently accumulated* undivided profits or surplus."

In the light of the foregoing purposes, we may more readily determine the questions here involved.

POINT I.

AS USED IN SECTION 31-b OF THE 1917 ACT, THE "MOST RECENTLY ACCUMULATED UNDIVIDED PROFITS OR SURPLUS" MEANT THOSE WHICH HAD BEEN EARNED BY THE CORPORATION BEFORE AND UP TO THE DIVIDEND DISTRIBUTION, AND DID NOT INCLUDE THOSE COMING INTO EXISTENCE DURING THE SAME YEAR BUT AFTER THE DISTRIBUTION.

The question here presented is one of law. With reference to a dividend distribution, what are the "most recently accumulated undivided profits or surplus" within the meaning of Section 31-b? The District Court held that the most recently accumulated profits of The B. F. Goodrich Company were those existing before and up to the dividend distribution, namely, the 1916 profits. The record shows and Mason pointed out in the Circuit Court of Appeals that the corporation had no current profits earned for the year 1917, either at the time of the declaration or of the payment of the dividends in question, and therefore claimed that those most recently accumulated by the company were the 1916 profits.

The Circuit Court of Appeals proceeded upon the assumption that the facts were true as claimed by Mason, but disposed of this question adversely to the taxpayer, by determining that the "most recently accumulated undivided profits or surplus" did not mean those most recently earned by the corporation before the dividend distribution, but meant those "*finally ascertained and entered* as the profits for the entire year during which dividends were paid." And since the corporation earned profits during the year 1917 after July 2nd, which appeared on its books at the end of that year, the Court held that these constituted the most recently accumulated profits from which the dividends in question were deemed to have been paid.

In its opinion the Court of Appeals said: (R. p. 28)

"This brings us to the phrase 'most recently accumulated' profits. This may refer to any one of three kinds of profits. *First,* those which at the time of the dividend payment have been formally recognized and entered on the books as profits for a fixed period, and are normally destined to be paid out in dividends; *second,* those which in fact have then come into existence but have not been ascertained or stated on the books; *third,* those which are finally ascertained and entered as the profits for the entire year during which dividends are paid. The first construction must be rejected on the authority of *Edwards vs. Douglas.* The second is logically permissible, but is impracticable. Not only may profits seeming to exist in July disappear before the end of the year, but it is often, if not typically, humanly impossible to determine with any accuracy in what months of the year the profits were made. To attempt to administer the law upon this theory would bring endless and hopeless confusion and disputes. A meaning which would inevitably make the law most difficult of application and in large degree unworkable ought not unnecessarily to be attributed to Congress.

"The *third construction* cannot be spelled out in the very words of the law; but if the entire taxing year should be taken as a unit, as Justice Brandeis says should be done (probably as applied here meaning 1917), it is seen that when the return was made in March, 1918, the taxpayer knew that profits had been accumulated in 1917 from which all 1917 dividends could be paid; and it is not unreasonable to suppose that the 'most recently accumulated profits' are to be judged from the end of the fiscal year during which the income was received. * * * and we conclude that the principle on which *Edwards vs. Douglas* was decided requires us to adopt this third construction."

Based on these holdings the Court decided that all the dividends received by Mason in 1917 should be taxed at

the 1917 rate, notwithstanding the Company had earned no profits for that year up to July 2nd.

This reasoning and decision of the Circuit Court of Appeals are in plain conflict with the holding of this Court in *Edwards vs. Douglas.*

The Court of Appeals says that the phrase "most recently accumulated profits" may refer to any one of three kinds of profits:

> *First.* Those which at the time of the dividend payment have been formally recognized and entered on the books as profits for a fixed period and are normally destined to be paid out in dividends.
>
> *Second.* Those which in fact have then come into existence but have not been ascertained or stated on the books.
>
> *Third.* Those which are finally ascertained and entered as the profits for the entire year during which dividends are paid.

The first construction was rejected on authority of *Edwards vs. Douglas.*

The *second* construction was rejected, on the ground that it was impracticable and unworkable and "ought not unnecessarily to be attributed to Congress." This construction was the one which had been adopted by the Department and for a number of years had been found practicable and workable. It was the construction which was adopted by this Court in *Edwards vs. Douglas;* and, in the outset, the holding of the Circuit Court of Appeals rejecting this construction was in direct conflict with that decision.

It was the claim of Douglas that within the meaning of the law the undivided profits or surplus must be those which had been determined and entered on the books of the Company at the end of the preceding year, although it was conceded that ample current profits had been earned

and were available. It was the claim of the Government that the "most recently accumulated" profits or surplus included current earnings and profits, whether entered on the books or not. The entire litigation centered around this controversy, and this Court held that "most recently accumulated profits" included current earnings, whether or not entered on the books.

On page 214 of the opinion, Mr. Justice Brandeis said:

> "On the other hand, the term 'undivided profits' has not acquired in corporate finance and accounting a like fixed meaning. It is not known as designating generally in business an account on the corporation's books, as distinguished from profits actually earned but not yet distributed. Few business corporations establish an 'undivided profits' account. By most corporations the term 'undivided profits' is employed to describe profits which have neither been distributed as dividends nor carried to surplus account upon the closing of the books; that is, current undistributed earnings.
>
> "That this is the natural meaning of the term 'undivided profits' is indicated by the action of both Douglas and his estate. That this is the meaning in which it was used by Congress is confirmed by the use of the expression 'earnings and profits' later in the same paragraph, and, also, by the use of the term 'undivided profits' in Section 207."

After stating the general aim of Congress in adopting Section 31-b, this Court, on page 216 of its opinion, said:

> "In providing measures for the attainment of that aim, it could be of no practical significance whether, *at the time of the payment of the dividend,* these profits appeared in a surplus or undivided profits account (as the profits earned within part of a year would, where a corporation closed its books monthly, quarterly, or semi-annually) or whether they still rested as current earnings without formal determination or specific allocation."

This language could not be more appropriate as an answer to the reasoning of the Circuit Court of Appeals if it had been now used by this Court for that express purpose.

The second construction should therefore have been adopted.

The *third construction* was adopted by the Circuit Court of Appeals and made the basis of its decision. We believe that this construction cannot be sustained on any theory. It also is in conflict with the principles announced in *Edwards vs. Douglas.*

In advance of stating its reasons for this holding, the Circuit Court of Appeals said that this construction "*cannot be spelled out in the very words of the law.*" An examination of the Section will show that this statement is undoubtedly correct. But it is universally held that a construction of a taxing law which cannot be found or spelled out in the words of the law should not be adopted or applied. *U. S. vs. Merriam,* 263 U. S. 179. Citing *Partington vs. Attorney General,* 4 H. L. 100, 122; *Eidman vs. Martinez,* 184 U. S. 578, 583; *Smietanka vs. Bank,* 257 U. S. 602, 605, 606.

This Court did not suggest a construction which could not be spelled out in the words of the law; and an examination of the opinion in *Edwards vs. Douglas* will show that this *third* construction is contrary to that decision.

If, as held by this Court, the most recently accumulated profits or surplus referred to in Section 31-b were not confined to those which were determined and entered on the books at the close of a year, but included current earnings from the first of the current year up to the dividend distribution,—then certainly, the Circuit Court of Appeals was wrong in holding that the most recently accumulated profits, etc. were those "which are finally ascertained and *entered* as profits for the *entire* year," to be "judged from

the end of the fiscal year during which the income was received."

In *Edwards vs. Douglas* it was undisputed that the profits accumulated for the calendar year 1917 were more than sufficient to pay all dividends distributed during that year.

If, in determining whether dividends were distributed out of the current year's profits, it were only necessary to find those "finally ascertained and *entered* as the profits for the entire year," then the whole analysis and reasoning of this Court in *Edwards vs. Douglas,* with reference to the meaning of "undivided profits," would have been beside the point. This Court would have needed to go no further than to find the conceded fact that the entire year's profits, entered at the end of the year, were more than the year's dividends.

But this Court did not intend any such construction. Throughout the opinion of Mr. Justice Brandeis the words "current earnings" and "current undistributed earnings" are repeatedly found, referring to the current earnings from the first of the year up to the dividend date. For example, on page 208 of the opinion the following appears:

> "It is not suggested that the approximate amount of the undivided current earnings of 1917 accrued and undivided *at the times these dividends were paid* was not in fact known to be sufficient for this purpose."

Also, on page 216, the following appears:

> "In providing measures for the attainment of that aim, it could be of no practical significance whether, *at the time of the payment of the dividend,* these profits appeared in a surplus or undivided profits account * * * or whether they still rested as current earnings without formal determination or specific allocation."

It is true that in *Edwards vs. Douglas* this Court did not in express terms determine the meaning of "most recently accumulated undivided profits" as applied to a cor-

poration which had no earnings for the current year up to the time of the dividend distribution. But the only inference to be drawn from that decision is that "most recently accumulated profits" mean only those earned *before and up to* the time of the distribution. If profits earned *after the distribution* were to be included, the entire discussion as to the use and application of "current earnings" would have been unnecessary.

Notwithstanding the evident conflict between its decision and that of this Court in *Edwards vs. Douglas,* the Circuit Court of Appeals announced that it was following and conforming to that decision. The Court said (R. p. 28):

> "The third construction cannot be spelled out in the very words of the law; but if the entire taxing year should be taken as a unit as Justice Brandeis says should be done, * * * it is seen that when the tax return was made in March, 1918, the tax payer knew what profits had been accumulated in 1917."

and finally the following:

> "We conclude that the principle on which *Edwards vs. Douglas* was decided requires us to adopt this third construction."

The "principle" referred to is found in a single line of the opinion of Mr. Justice Brandeis, which we believe was given a meaning not warranted by its context.

On page 216 of the opinion in *Edwards vs. Douglas,* the following appears:

> "Its general aim was clearly to make the dividend, in whatever year paid, bear the tax rate of the year in which the profits of which it was a distribution had been earned; *and for this purpose to treat as a unit the profits of the whole tax year.*" (Italics ours.)

It was the last clause in this statement which was seized upon by the Circuit Court of Appeals, and treated as giving color to the whole decision.

It will be observed that Mr. Justice Brandeis did not say that the "entire *taxing year* should be treated as a unit," as stated by the Circuit Court of Appeals. What he did say was, "and for that purpose to treat as a unit the *profits* of the whole tax year." There is a plain difference between treating an entire *taxing year* as a unit, and treating as a unit the *profits* of a whole tax year. Furthermore, the purpose referred to by Mr. Justice Brandeis was entirely overlooked. What was the purpose of treating as a unit the profits of a whole tax year? This is shown by the context, both preceding and following, namely: to make the dividend, in whatever year paid, bear the *tax rate* of the year in which the profits entering into it had been earned.

For example, the 1917 tax rate was high. A lower tax rate had been fixed for the year 1916, and still lower for the year 1915. If a corporation had accumulated profits which had been earned in those years respectively, then all of the profits of any one year would be treated as a unit, every part of which, whenever distributed, would bear the tax rate for that year; so that if any part, whether large or small, should be taken out and distributed as a dividend, the amount so distributed would bear the tax rate of that year.

Mr. Justice Brandeis was construing and giving application to the provision:

> "and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation."

The Circuit Court of Appeals used his statement as a construction of the earlier provision:

> "shall be deemed to have been made from the most recently accumulated undivided profits or surplus."

The use of a statement made to explain the determination of a *tax rate*, which would be applicable to the profits of a given year, as a construction of "the most recently

accumulated profits or suplus," must lead to erroneous results.

In addition to all the foregoing, the construction of Section 31-b which was adopted by the Circuit Court of Appeals is contrary to the express terms of that Section; and is contrary to its meaning, as shown by its history. It would also render impossible the uniform application of the law; and is in direct conflict with the regulations, practices and accounting of the Treasury Department from the time when the law of 1917 went into effect.

It is plain that the provision, "shall be deemed to have been *made* from the *most recently accumulated* profits or surplus," when applied to a dividend distribution, speaks in the past tense, as to profits already in existence, and not those to be earned in the future. How could a distribution be "*deemed to have been made*" from profits not in existence?

The expression, "most recently accumulated", refers to profits which have already been earned up to the time of the distribution. No taxpayer could reach the understanding that the law referred to profits not then in existence but which *might* thereafter be earned. That the Department itself construed the law as referring to past profits or surplus, and by its regulations and practices applied it in this way, will be hereinafter shown; and that taxpayers had the right to so construe it is evident from the ordinary meaning of the words used.

The history of Section 31-b during its progress through the Houses and Committees of Congress demonstrates the intention of Congress as to its meaning. In the Senate Bill, as first passed, it was provided that "any distribution made to the shareholders * * * of a corporation * * * shall be deemed to have been made *from the net income of the year in which such distribution is made or, if such income is insufficient,* from the most recently accumulated undivided

profits or surplus" (See Congressional Record, Vol. 55, part 7, pp. 6869-70, 6877-86).

The Conference Committee eliminated the italicized words. Had the Senate Bill passed unchanged, it would have expressed exactly the holding which was made by the Circuit Court of Appeals in this case. Had the omitted provision been retained in the law, however, no one could have determined, at the time of a dividend distribution, from what year's earnings it would be deemed made. Congress therefore eliminated this provision from the bill which was finally passed, thus conclusively demonstrating its intention that dividend distributions should not be deemed to have been made from earnings not then in existence but later accumulated.

Furthermore, the construction adopted by the Circuit Court of Appeals would render nugatory the express provision of Section 31 (b)—

> "But nothing herein contained shall be construed as taxing any earnings or profits accrued prior to March 1, 1913, but such earnings or profits may be distributed as stock dividends or otherwise, exempt from tax, after the distribution of earnings and profits accrued since March 1, 1913, has been made."

This provision contains no limitation as to the time during the year when the distribution may be made exempt from tax, but unless the most recently accumulated undivided profits or surplus for the current year referred only to the current profits up to the date of the distribution, and not to those thereafter earned, the Board of Directors would never be able to determine whether or not they had distributed the earnings and profits accrued since March 1, 1913. Such a result for this provision could not have been intended by Congress.

The construction of Section 31 (b) adopted by the Circuit Court of Appeals would render the uniform application of the law impossible.

If the most recently accumulated profits for a current year were those "finally ascertained and entered as the profits for the entire year during which dividends are paid," neither a taxpayer nor the Department could apply the law to the yearly earnings of a corporation which operated on the basis of a fiscal year not corresponding with the calendar year. In such a case the termination of the fiscal year might be after the time when the tax return was filed, and would include parts of two calendar years. It would then be impossible to determine with any accuracy, and could not be determined at all from the books, as to what rates would be applied in case the rates of the two years were different.

That the decision of the Circuit Court of Appeals adopting this third construction is incorrect and should not be approved, is shown also by the fact that it is in conflict with the regulations, practices and accounting adopted and applied by the Treasury Department from the time when the law of 1917 went into effect until the Circuit Court of Appeals rendered its decision in this case. The understanding of the Treasury Department and the indication of its rulings and dealings with taxpayers are shown by Treasury Regulation No. 33, which provided that:

> "If a corporation distributed dividends in 1917, such dividends will be deemed to have been paid from earnings of 1917, and the recipient, if an individual, will be liable to additional tax if any, and if a corporation, to income tax at the rates for the year 1917, unless it is *shown to the satisfaction of the Commissioner of Internal Revenue that at the time such dividends were paid the earnings up to that time were not sufficient to cover the distribution, in which case the excess over earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years,* and will be taxed at the rate or rates for the year or years in which earned."

POINT II.

FOR THE PURPOSE OF DETERMINING FROM WHAT YEAR'S PROFITS OR SURPLUS A DIVIDEND DISTRIBUTION IS DEEMED TO HAVE BEEN MADE, THE DIVIDEND DECLARATION CONSTITUTES THE "DISTRIBUTION" WITHIN THE INTENT AND MEANING OF SECTION 31-b.

By reason of the situation as to the 1917 earnings and profits of The B. F. Goodrich Company, this case could safely be disposed of on the considerations hereinbefore set forth, but in view of the decision of the District Court, which was reversed by the Circuit Court of Appeals, and because the public interest requires a complete construction of this Act, it is important that the second erroneous holding of the Circuit Court of Appeals be considered.

The law does not in terms specify or define what shall constitute the "distribution" which is deemed to have been made from the most recently accumulated profits or surplus.

The District Court in this case determined that the dividend distributions made by The B. F. Goodrich Company, and not the payment constituted the "distribution" (R. pp. 18, 19), and since The B. F. Goodrich Company had earned no profits for 1917 up to that time, determined that the distribution should be deemed to have been made from the 1916 surpluses of the Company (R. pp. 18, 19).

The Circuit Court of Appeals reversed this holding upon the grounds stated in its opinion (R. p. 27):

> "The Court below concluded that the 'distribution' was made when the dividend was declared, segregated from the body of undivided profits, and became a debt from the company to the stockholder which he could sell independently of the stock. *That as between the stockholder and the corporation and from many points*

> *of view such a declaration is a distribution of profits, is indisputable;* but this is a taxing statute, the dominant thought of which is that the citizen should suffer an annual burden upon his annual income. *'Distribution' must mean a disposition which at that moment results in income;* because to ascertain taxable income is the purpose and subject matter of the Act, and a dividend declared this year, payable in the next or some other distant year, is not within the normal conception of income for this year." (Italics ours)

Here we find the assertion that the language of the Act, although it has a well defined and well recognized legal meaning for all ordinary business purposes, is to be given a different and new meaning and interpretation, not ordinarily used or understood, merely because it occurs in a taxing statute. Such a doctrine would generally be deemed unsound. But when the result of it is to impose taxation, it then becomes plainly contrary to the fundamental rules of law for the interpretation of taxing statutes.

The statement of the Court that

> "distribution must mean a disposition which at that moment results in income; because to ascertain income is the purpose and subject matter of the Act,"

likewise disregards the purpose of Section 31-b as announced by this Court. The purpose of that section was to provide for fixing *tax rates* as to dividends, not to ascertain taxable income.

The conclusions of the Circuit Court of Appeals upon the grounds stated by it should not stand unless sustained by other and more persuasive considerations. We submit that a study of the section will indicate that the Circuit Court of Appeals erred in its conclusions.

It is undoubtedly true that the words *"any distribution made* to stockholders" are broad enough to cover and include any kind of distribution or any property distrib-

uted. The intention of Congress therefore, must be determined from the language of the Act, together with the known conditions of its adoption. Certain legal situations, which by implication affected and entered into this Act, were a matter of common knowledge.

Under the state laws generally no dividend could be declared except out of corporate profits or surplus found by the directors to be then in existence and available and sufficient for that purpose.

The courts of New York, under the laws of which The B. F. Goodrich Company was organized, and courts generally, had held that the act of declaring a dividend at once irrevocably created a debt from the corporation to each stockholder,—a property right which could be assigned, transferred or dealt with by the stockholder independently of his stock.

Wheeler vs. Northwestern Sleigh Co., 39 Fed. 347;
Bowers vs. Post, 209 Fed. 660;
U. S. vs. Guinzburg, 278 Fed. 363;
Hopper vs. Sage, 112 N. Y. 553;
Laurie vs. Trust Co., 272 N. Y. 137;
Fletcher, Cyc. of Corporations, Vol. 6, Sec. 3853; L. R. A. 1917 (b) 728 and 736;
U. S. Trust Co. vs. Barker, 33 N. Y. Supp. 388.

Upon the declaration of a dividend the surplus profits of the corporation are at once reduced and the obligations correspondingly increased.

All of this was generally understood and must have been in the mind of Congress.

The declaration of a dividend, therefore, was understood to effect a reduction of the assets of the corporation and to give property rights to the stockholders. The payment was a resulting ministerial incident. Had Congress intended to adopt any rule setting aside or modifying these

fundamental principles of corporate procedure and accounting, it certainly would have indicated that fact in unmistakable terms. Its silence must be taken to show its intention to treat, and authorize taxpayers to treat, the declaration of dividends in the way which had been customarily understood.

It must be conclusively presumed that Congress intended that directors should comply with the law and should only declare dividends out of the existing surpluses and undivided profits; and we cannot fairly assume that such dividend distributions were intended by Congress to be "deemed to have been made" out of profits not then in existence.

Having in mind this legal situation and its results, we may consider the terms and language of Section 31-b.

In view of the general aims of Congress hereinbefore referred to, as found by this Court, it will be kept in mind that Congress meant to prevent directors from determining, in connection with the declaration, as to what year's profits were thereby distributed, and intended to substitute for the discretion of the directors in this respect a conclusive presumption.

Since, in the absence of such presumption, the determination of the board as to what year's profits or surplus were distributed would be a part of the declaration of a dividend, it would follow that the *conclusive presumption* which took the place of the exercise of such discretion, would relate to, and take effect as of, the time of such declaration. Indeed, it would by implication, enter into and be a part of the declaration of every dividend.

It cannot be presumed that Congress contemplated that the declaration of a dividend and the payment thereof would each separately constitute the "distribution." In view of the known legal requirements for and the legal results of a dividend declaration, is it not evident that by

using the comprehensive words, "any distribution," Congress intended to designate and embrace the declaration, which appropriates the corporate profits and creates the corporate obligations to the stockholders? This interpretation would give harmonious meaning and effect to the entire section.

An indication as to the intent of Congress in using the words, "any distribution" is found in the language of this section. It begins with the statement:

> "*Any distribution* made to the shareholders * * * shall be deemed to have been made from the most recently accumulated profits or surplus."

Following this is the statement:

> "and shall constitute a part of the annual income of the distributee *for the year in which received.*"

If the distribution by the corporation here referred to had been intended to be synonymous with receipt of payment by the stockholder, then the second clause was unnecessary; but here two ideas are expressed, both of which refer to dividends declared by corporations.

Thus the declaration of the dividend, as to which the conclusive presumption is a part, is first dealt with; the receipt of payment thereof is dealt with separately. Had Congress intended only to deal with the receipt of payment, and to provide that payment should be deemed to have been made from the most recently accumulated profits, etc., it would have been easy to express such intention in plain language, but this would have changed the sense of important parts of this section.

If we should substitute the words "dividends paid" for "distribution made," Section 31-b would read as follows:

> "Any dividends paid to the shareholders, * * * of a corporation * * * in the year 1917, or subsequent tax years, shall be deemed to have been paid from the

> most recently accumulated undivided profits or surplus, and *shall constitute a part of the annual income of the distributee for the year in which received,* and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, etc."

The italicized portion of the above clause is surplusage, because Section 1200 of the Act defines income to include gains, profits and income derived from dividends, and Sections 1 and 2 of the Act tax income *received* in the calendar year 1917, and every calendar year thereafter.

Substituting "dividends declared" in place of "distribution made", the section would read:

> "Any dividends declared to the shareholders of a corporation in the year 1917, or subsequent tax years, shall be deemed to have been declared from the most recently accumulated undivided profits or surplus and *shall constitute a part of the annual income of the distributee for the year in which received,* and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation."

In the foregoing, the italicized portion is essential to the meaning of the section, and, if omitted, would change Sections 1 and 2 so as to require taxpayers to pay the tax on *dividends declared* as distinguished from dividends received.

In addition to the foregoing, Section 31-b contains a further demonstration that Congress intended "any distribution" to embrace the *declaration* of the dividend.

It will be observed that the words "any distribution made" are used in the first line of the section. The same words are used in the same way and in the same sense in the last clause of the section.

If the words, "this sub-division shall not apply to *any distribution made* prior to August 6, 1917," were in-

tended by Congress to embrace the declaration of dividends, then it undoubtedly follows that the same words used in the first line of the section must likewise include the declaration of dividends. These words were not used in identical form in two places by accident.

The meaning of "any distribution made" in the last clause is evident from the history of its enactment.

The proposed law was at first reported and given publicity without the last proviso. This was done on August 6, 1917. A great many corporations had acted in reliance upon the law as it then existed, under which dividends might be declared, free from tax, out of undivided profits and surplus earned prior to March 1, 1913. Many of such dividend declarations had been made even after August 1, 1917.

Upon the publication of the proposed act, protests were sent in from every direction. This is publicly known, and is shown and discussed in *Montgomery on Income Tax Procedure* (1918 Edition) page 153. Thereupon the Conference Committee, in order to prevent the grave injustice which would have resulted, had the law been enacted as first published, determined upon and reported the last proviso as a part of Section 31-b.

We should not impute to the Committee and to Congress the intention by this proviso to relieve stockholders who had received payment of such dividends before August 6, 1917, but to tax stockholders where such dividends had been declared, and the debts created, before that date, but actual payment had not been made.

Directors had acted in reliance upon the existing law, which permitted dividends to be declared and paid out of earnings prior to March 1, 1913 without tax. Such declaration of dividends appropriated the 1913 surplus and created indebtedness from the corporation to its stockholders which could not be revoked, and must be paid.

In granting the relief intended by the last proviso, it is not conceivable that Congress proposed to relieve a part of the stockholders who would have been innocently entrapped, but to withhold relief from the others who were in practical effect identically situated.

Within the intention of Congress, therefore, the words, "any distribution made," found in the proviso, must have embraced *the declaration* of the dividend. It follows that the same words found in the first line of this section were intended to have the same meaning.

The conclusion that the "distribution" by a corporation to its stockholders must be deemed to have been made from those profits which were, at the time of the dividend declaration, the most recently accumulated undivided profits or surplus, is sustained by the decisions of numerous courts and of the Board of Tax Appeals.

U. S. vs. Guinzburg, 278 Fed. 363; (C. C. A., 2nd Circuit);
Plant vs. Walsh, 280 Fed. 722;
Phillips vs. U. S., 12 Fed. (2nd) 598;
Appeal of A. H. Stange, 1 B. T. A. 810;
Appeal of Harmon W. Hendricks, 4 B. T. A. [illegible] C. C. H. 1926 B. T. A. Service, Vol. 3, p. 3259;
Appeal of Mary A. Fitzgerald, 5 B. T. A. 178, C. C. H. 1926 B. T. A. Service, Vol. 3, p. 3389;
Appeal of Maurice J. Curran, 5 B. T. A. 180, C. C. H. 1926 B. T. A. Service, Vol. 3, p. 3399.

In *U. S. vs. Guinzburg*, a corporation had declared a dividend on February 17, 1913, payable July 1, 1913. The Department claimed that when the dividend was paid it constituted taxable income of Guinzburg for the year 1913. The Circuit Court of Appeals held that the amount of this dividend was capital of the stockholder at the time the Act of 1913 took effect and not taxable income arising or accruing thereafter.

On pages 363 and 364 of the opinion the court said:

"We think the dividend declared prior to March 1, 1913, the effective date of the income tax here considered, was not income when paid because it was part of the capital of the defendant in error on March 1, 1913. By the declaration of a dividend, the earnings of the company, to the extent declared, were separated from the property of the corporation, and were appropriated by that action to the then stockholders, who became creditors of the corporation for the amount of the dividend. The relation then created was that of debtor and creditor (citing many authorities). It is the separation of the earnings from the balance of the corporate property, together with the promise to pay, arising from the declaration of the dividend, that works this change. The holder of the stock with respect to the dividend is on a par with other creditors of the corporation. *Staats v. Biograph Co.*, 236 Fed. 454. The fact that the dividend is payable at a future date does not alter the rights thus created. The obligation of the corporation as debtor commences with the declaration of the dividend although the payment is postponed for the convenience of the company. The rights of the stockholders are immediately vested the moment the dividend is declared. The action of the Board of Directors is the appropriation of a portion of the earnings to the defendant in error as the holder of a certificate of stock. The same rule prevails in the state courts of New York under which laws the corporation here in question was organized."

On page 366 the court said:

"We conclude that, upon the declaration of a dividend the debt was immediately created in favor of the defendant in error, payable at a future date. By that action, a vested right was created in favor of the stockholder, who could sell his right by assigning or pledging or otherwise disposing of it, and this was not income arising and accruing within the meaning of the statute such as might be taxed under the income tax act of March 1, 1913, here in question."

In *Appeal of A. H. Stange* (decided March 18, 1925) the Board of Tax Appeals construed sub-section (b) of Section 31 of the Revenue Act of 1917.

In that case the Directors, on January 27, 1917, declared a dividend of $125,000 "to be paid to the stockholders when and as directed by the officers or directors." This dividend was actually paid to the stockholders as follows:

August	8, 1917	$14,000.00
September	5, 1917	21,000.00
November	20, 1918	49,000.00
January	13, 1919	41,000.00

For each of the years from 1913 to 1916 inclusive, the corporation sustained losses. For each of the years 1917 to 1919 inclusive, the corporation had earnings and profits sufficient to pay the amounts of dividends actually paid in those years. The Commissioner proposed to tax the amounts actually paid in each of the years as dividends in those years.

The Board of Tax Appeals held that these dividends were distributed out of surplus accumulated prior to March 1, 1913, and therefore were not taxable.

On page 813 the Board stated in its opinion:

> "From the above authorities we are of opinion that the resolution of the Board of Directors of A. H. Stange Co. of January 27th constituted a valid declaration of a dividend at that time, even though payment was to be made when and as directed by the officers or directors.
>
> "The determination of the principal question herein depends, in the last analysis, upon the construction which must be given to the words, 'any distribution made,' as used in Section 31-b of the Revenue Act of 1917. If these words have reference to the declaration of a dividend, the taxpayer must prevail; if they mean the actual time of payment of the dividend, then it will

be necessary to construe the limitation upon distribution of the earnings and profits in said section. It is therefore necessary to ascertain the legal effect of a resolution declaring a dividend. The definition of a dividend in Section 31-a of the 1917 Act as 'any distribution made or ordered to be made by a corporation * * * out of its earnings or profits * * * and payable to its shareholders' comports with the general definition of a dividend, and for the purposes of this case may be taken as correctly defining a dividend declared out of earnings or profits accrued prior to March 1, 1913. What then is the legal effect of the declaration of a dividend? We think the answer to this question is clearly set forth by the court in *U. S. v. Guinzburg,* 278 Fed. 363, wherein the court said (here follows a long quotation from the opinion in the *Guinzburg* case).

"The outstanding features of a dividend declaration are that, by the mere declaration, the dividend becomes thereby separated and segregated from the stock and exists independently of it; the right thereto becomes immediately fixed and absolute in the stockholders, and the corporation becomes a debtor to its stockholders for their pro rata shares. There is an apportionment or division of the assets of the corporation, to the extent of the dividend, to its stockholders. The corporation is at once poorer in the amount of the dividend declaration, and the stockholder becomes richer in his own right, to the extent of his pro rata share. What theretofore existed as undivided profits or surplus has become divided profits and the surplus is reduced to the extent of the dividend declared. It has ceased to be the property of the corporation and has become the property of the stockholder, and his interest therein becomes adverse to the corporation and to every other stockholder. We think this division or segregation of the amount of the dividend from the general mass of the corporate property and its apportionment to the stockholders is included in the words any distribution made, as used in the statute, and that those words must be given the same legal ef-

fect as results from the declaration of a dividend. It follows that the resolution of the board of directors of A. H. Stange Co., passed on January 27, 1917, constitute a distribution to its stockholders at that time of the surplus existing at March 1, 1913, and the fact that payment was made in subsequent years becomes immaterial.

"It remains to apply the provisions of section 31 (b) of the 1916 Act. By that section any distribution made in the year 1917 or subsequent tax years is deemed to have been made from the most recently accumulated undivided profits or surplus, and the presumption thus raised has been held to be a conclusive presumption. *Harder v. Irwin*, 285 Fed. 402; *Douglas v. Edwards*, 298 Fed. 229. The facts herein show that A. H. Stange Co. had operated at a loss in all the years from 1912 to 1917, and there were no undivided profits since 1913 out of which a distribution could have been made, and this appeal could be sustained on that ground. We prefer, however, to rest our decision upon the last sentence of section 31 (b), providing:

"This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

"Holding, as we do, that the words any distribution made, as used in the statute, include the declaration of a dividend and must have the same legal effect; and the dividend in question having been declared prior to August 6, 1917, to-wit, on January 27, 1917, the presumption that the distribution was from the most recently accumulated undivided profits or surplus has no application to the facts in this appeal. We are of opinion that the distribution made by the A. H. Stange Co. to its stockholders on January 27, 1917, out of a surplus existing prior to March 1, 1913, is exempt from taxation to the taxpayer herein at the time of the actual payment, and the determination of the Commissioner proposing to tax the same in the years in which it was paid must be disapproved."

In *Appeal of Hendricks, Appeal of Fitzgerald* and *Appeal of Curran, supra,* (decided in September and October, 1926), the Board of Tax Appeals referred to and followed its holding in *Appeal of A. H. Stange.*

CONCLUSION.

The B. F. Goodrich Company had no undivided profits for the year 1917, either at the time of the declaration or at the time of payment of the dividends in question. We believe that the most recently accumulated profits or surplus are those earned before and not after the distribution. In this case those were the profits of 1916. We further believe that in determining the profits distributed, "any distribution made" refers to the declaration of the dividend.

It follows that the District Court was correct in entering judgment in favor of Mason and that the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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26840—27

In the Supreme Court of the United States

OCTOBER TERM, 1926

No. 770

F. H. MASON, PETITIONER

v.

C. F. ROUTZAHN, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court (R. 22) is reported in 8 F. (2d) 56, and that of the Circuit Court of Appeals (R. 38) in 13 F. (2d) 702.

JURISDICTION

The judgment sought to be reviewed was entered on June 30, 1926. (R. 37.) A petition for rehearing was entertained and was denied on October 7, 1926. (R. 57.) Jurisdiction to grant the writ prayed for is conferred upon this Court by Section

240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATEMENT

This suit was brought to recover income taxes paid on certain corporate dividends received by petitioner from The B. F. Goodrich Co. during 1917 and included in his return of income for that year. The dispute is over the rate at which such income was taxable. The statute to be applied is Section 31(b) of the Revenue Act of 1916 (added by Section 1211 of the War Revenue Act of 1917, c. 63, 40 Stat. 300, 338), which is as follows:

> (b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, etc.

The case was tried on a stipulation of facts (R. 7) which in some respects is inadequate. The dividends received by petitioner were as follows (R. 3, 8):

ON COMMON STOCK

Date of declaration	Date of payment	Received by Mason
October 25, 1916	February 15, 1917	$22, 781. 00
January 24, 1917	May 15, 1917	22, 781. 00

ON PREFERRED STOCK

October 25, 1916	January 2, 1917	$17, 517. 50
January 24, 1917	April 2, 1917	17, 473. 75
January 24, 1917	July 2, 1917	17, 473. 75

The stipulation does not show whether the dividend resolutions directed that the dividends should be payable to the stockholders of record at the dates of the declarations, or at some later dates. These dividends were included by the petitioner in his income tax return for the year 1917 (R. 3), and reported by him as paid from surplus accumulated by the corporation during 1916, and he paid a tax thereon at the rates prescribed by law for 1916.

Thereafter the Commissioner of Internal Revenue levied an additional tax on the theory that the distributions of the dividends were made when the dividends were paid in 1917, not when they were declared, and that at the respective dates of payment there were net earnings accumulated during 1917 sufficient to pay the dividends, which were therefore presumed to be paid out of 1917 earnings and taxable at the 1917 rate, which was higher than for 1916.

The stipulation shows that at the close of the year 1917, taking the year's business as a whole,

the books of the corporation disclosed net earnings for 1917 in more than the amount of the dividends paid in 1917. (R. 12.) It also appears that agreements were made by the B. F. Goodrich Co. with dealers in its tires under which the bulk of the tires made between January 1 and July 1, 1917, were sent to dealers, and which provided that the dealers might return, under certain conditions, during September and October, 1917, tires they were unable to sell. (R. 9 et seq.) It was stipulated that if these contracts did not amount to "firm sales," the company had no actual profits earned in 1917 prior to the date of dividend payments, and that all of its profits for 1917 were actually earned after the dividend payments. (R. 15.) Notwithstanding statements in the opinion of the trial court to the contrary (R. 23), there is nothing in the record to show that at the time the dividends were declared the corporation attempted to specify that the dividends were to be paid out of earnings for any particular year. An announcement that they were so paid was first made January 28, 1918, in a letter to the stockholders. (R. 13.)

ARGUMENT

It may fairly be claimed that the stipulation of facts in substance shows that there were no actual net earnings in 1917 prior to the dates the dividends were paid. Accepting the theory of the Collector that the date of payment and not the

date of declaration of a dividend is the date of distribution within the meaning of Section 31(b), in order to establish that there were 1917 earnings available when the dividends were paid and that the distributions were made out of 1917 earnings, it is necessary to adopt the theory that the earnings for the year disclosed at the end of the year must be treated as a unit and a pro rata share of them assumed to be earned during each month of the year.

After that point is disposed of favorably to the Collector, the question then arises whether a distribution is made, within the meaning of the statute, when a dividend is declared or when it is paid. This is important, since a distribution scarcely may be made out of earnings subsequently accumulated.

While *Edwards* v. *Douglas*, 269 U. S. 204, settled the point that the most recently accumulated undivided profits or surplus may be those of the current year, and not alone those accumulated at the close of the preceding fiscal year, we do not see that either of the questions above stated was necessarily involved or decided. That case dealt with two dividends paid in September and December, 1917. While the opinion does not mention it, the record in that case (pp. 32, 33) shows that one dividend was declared September 13, to be paid September 28 to stockholders of record September 24, 1917. The other was declared December 13, to be paid December 28 to stockholders of record on December 18,

1917. Since so short a time elapsed between declaration and payment, and both events occurred in the same year, the question whether date of declaration or date of payment should be considered the date of "distribution" was not important and was not presented or considered. The opinion speaks of the date of payment as the date of distribution, but under the circumstances no special significance can be attached to the words used.

The other point, as to whether there must be actual earnings for the current year at the date of the distribution or whether the earnings for the year as a whole may be taken as a basis and prorated for the purpose of ascertaining current earnings available for distribution at date of distribution, *Edwards* v. *Douglas* does not settle. The opinion, while referring to the fact that the District Court, in determining the 1917 earnings for the fraction of a year prior to the dividend payment, prorated the entire year's profits, pointed out that it was not suggested that the actual accrued earnings for that part of the year 1917 prior to the dividend dates, were not sufficient to pay the dividends. There is a statement in the opinion that the fiscal year must be treated as a unit. On the case as disclosed, that decision may be authority for the proposition that a pro rata share of the entire year's earnings may be treated as approximating the actual earnings for a fraction of the year, in the absence of proof that there were no earnings actually accumulated during the fractional period.

It falls short of being authority for the rule that the unit and prorating method may be used where it affirmatively appears, as may be claimed here, that no earnings were actually accumulated for the year until after the distributions were made. We are obliged to concede that the two questions are open and debatable.

There is one feature of this case that seems to have so far escaped attention. Two of the dividends were declared in 1916. If the petitioner and District Court are right in concluding that the distribution is made, within the meaning of Section 31(b) of the Revenue Act of 1916, when the dividend is *declared,* then these two distributions were made in 1916. Section 31(b), providing for application of the tax rate for the year in which the corporate earnings were accumulated, only relates to distributions made "in the year 1917, or subsequent tax years." It would follow that if the dividends declared in 1916 are considered distributions made in 1916, as petitioner asserts, Section 31(b) has no application, and there is no statute applicable to those two distributions changing the ordinary rule that the rate of taxation is that for the year for which the return is made.

On the theory that the distribution of the two dividends was made in 1916 and the amount thereof passed to the credit of the stockholder when declared, the amount was *accrued* income to the stockholder when declared in 1916, but *received* income when paid in 1917.

If he made his returns on a receipts and disbursements basis (as he seems to have done), he was required to include in his 1917 return for taxation at the 1917 rate the two dividends declared in 1916. This produces the incongruous result that although the distributions are said to be made in 1916, when the two dividends were declared, nevertheless they were not received for tax purposes until paid in 1917.

Carrying this to its logical conclusion, a dividend declared in 1916 and paid in 1917 if returned on a receipts and disbursements basis, would take the 1917 rate; while a dividend declared in 1917 and paid on the same date in 1917 as the other, would take the 1916 rate, if there were no 1917 earnings, or if the 1917 earnings were actually earned after the dividend payments and the method of prorating the entire year's earnings is rejected. This seems to indicate something wrong with petitioner's theory that declaration is distribution as the latter word is used in this section of the statute, and that the Circuit Court of Appeals may be right in the conclusion that within the meaning of the word as used in Section 31(b) a distribution means a payment of a dividend. This confirms the impression that there is room for discussion on the questions here presented.

The Treasury Department advises that a number of cases are pending in the courts presenting the same questions, and that notwithstanding that Section 31(b) was not reenacted in later revenue

acts, a very large number of cases involving these points are not finally closed by settlement or the statute of limitations.

For these reasons the United States does not oppose the issuance of the writ.

Respectfully submitted.

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JANUARY, 1927.

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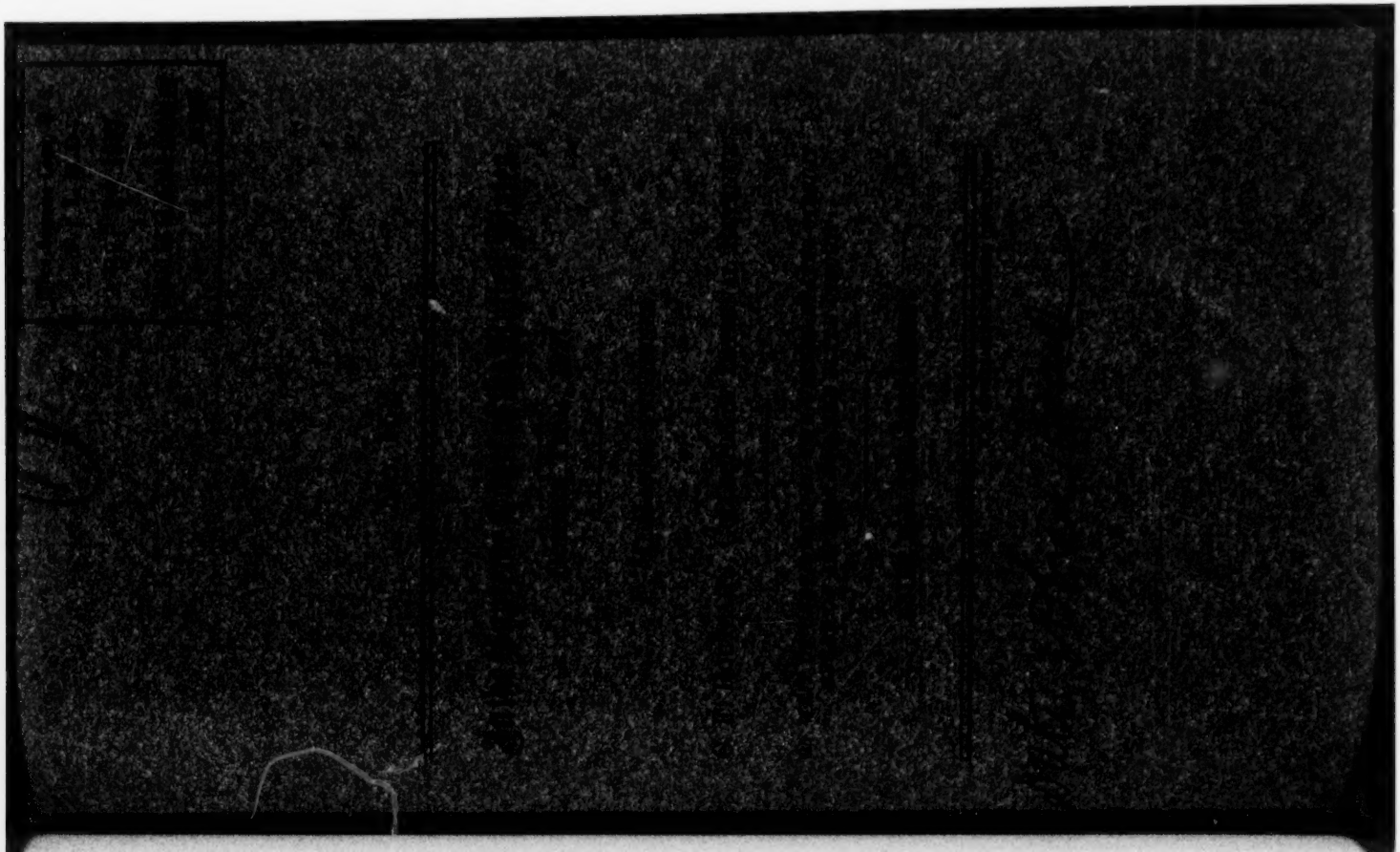

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In the Supreme Court of the United States

OCTOBER TERM, 1927

No. 152

F. H. MASON, PETITIONER

v.

C. F. ROUTZAHN, COLLECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 16) is reported in 8 F. (2d) 56, and that of the Circuit Court of Appeals (R. 26) is reported in 13 F. (2d) 702.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 30, 1926. (R. 26.) A petition for rehearing was entertained and was denied October 7, 1926. (R. 30.) The petition for certiorari was filed December 14, 1926, and granted January 17, 1927 (R. 30), pursuant to Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

THE QUESTIONS

1. Under subdivision (b) of Section 31 of the Revenue Act of 1916 (added by the Revenue Act of 1917), providing that any distribution made to shareholders shall be deemed to have been made from the most recently accumulated profits and shall be taxed to the distributee at the rate prescribed for the year in which the profits were accumulated by the corporation, are distributions made to the shareholders during 1917 taxable to the shareholder at the 1917 rate if the corporation had no earnings for that year at the date of distribution sufficient to pay them but made sufficient earnings before the close of the year;

2. Is the date of the declaration of a dividend or the date of its payment the date of distribution within the meaning of Section 31 (b)?

THE STATUTE

The statute involved is Section 31 of the Revenue Act of 1916, added by Section 1211 of the Revenue Act of 1917 (Act of October 3, 1917, c. 63, 40 Stat. 300, 336–338), which provides:

> SEC. 1211. That Title I of such Act of September eighth, nineteen hundred and sixteen, is hereby amended by adding to Part III six new sections, as follows:
>
> * * * * *
>
> "SEC. 31(a). That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, associ-

ation, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

"(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributees for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

STATEMENT

This suit was brought to recover income taxes paid on certain corporate dividends received by petitioner from The B. F. Goodrich Company during 1917 and included in his return of income for that year. The dispute is over the rate at which such income was taxable. The statute to be applied is that above set forth.

The case was tried on a stipulation of facts (R. 6), which in some respects is inadequate. The dividends received by petitioner were as follows (R. 6, 7):

ON COMMON STOCK

Date of Declaration	Date of payment	Received by Mason
October 25, 1916	February 15, 1917	$22, 781. 00
January 24, 1917	May 15, 1917	22, 781. 00

ON PREFERRED STOCK

October 25, 1916	January 2, 1917	$17, 517. 50
January 24, 1917	April 2, 1917	17, 473. 75
January 24, 1917	July 2, 1917	17, 473. 75

The stipulation does not show whether the dividend resolutions directed that the dividends should be payable to the stockholders of record at the dates of the declarations, or at some later dates. These dividends were included by the petitioner in his income-tax return for 1917 (R. 12) made on the

receipts and disbursements basis, and reported by him as paid from surplus accumulated by the corporation during 1916, and he paid a tax thereon at the rates prescribed by law for 1916.

Thereafter the Commissioner of Internal Revenue levied an additional tax on the theory that the distributions of the dividends were made when the dividends were paid in 1917, not when they were declared, and that at the respective dates of payment there were net earnings accumulated during 1917 sufficient to pay the dividends, which were therefore presumed to be paid out of 1917 earnings and taxable at the 1917 rate, which was higher than for 1916. (R. 13.)

The stipulation shows that at the close of the year 1917, taking the year's business as a whole, the books of the corporation disclosed net earnings for 1917 in more than the amount of the dividends paid in 1917. (R. 11.) It also appears that agreements were made by The B. F. Goodrich Co. with dealers in its tires under which the bulk of the tires made between January 1 and July 1, 1917, were sent to dealers, and which provided that the dealers might return, under certain conditions, during September and October, 1917, tires they were unable to sell. (R. 9, 10.) It was stipulated that if these contracts did not amount to "firm sales," the company had no actual profits earned in 1917 prior to the date of dividend payments, and all of

its profits for 1917 were actually earned after the dividend payments. (R. 14.)

SUMMARY OF ARGUMENT

I. The decision of the Circuit Court of Appeals that the earnings for 1917, although shown to have been made after the dates of payment of the dividends, may be treated as the source of payment is submitted, but without support in this brief.

The decision in *Edwards* v. *Douglas*, 269 U. S. 204, does not go further than to hold that the earnings for the whole year may be pro rated to ascertain the current earnings at any date, if there is nothing to show such method inaccurate. The purpose of the statute does not require that the source of any dividend should be considered earnings made after the dividend was paid.

The regulations of the Treasury Department construed the statute to mean that only earnings made prior to a dividend payment should be treated as its source, and there is no good reason to overturn this settled practice.

II. The stipulation of facts adopted in the findings shows that at the respective dates of payment of the dividends no earnings for 1917 had been made.

III. A distribution was made, within the meaning of Section 31, when the dividend was paid, not when it was declared.

That was the interpretation of the statute promptly adopted in the Treasury regulations and since uniformly applied and no sufficient reason is advanced to reject the settled practice under a statute long since repealed.

Examples are given of incongruous results which would follow from the rule that the date of declaration of a dividend is the date of distribution.

The purpose of the statute, which was to treat the latest earnings as the source of dividends, would be defeated by treating the declaration of a dividend as a distribution made, where the payment of the dividend was postponed.

The propositions that a declaration of a dividend should be based on surplus then existing, and creates a debt owing to the stockholder, have no relation to the purpose of this statute or the question under consideration.

If declaration, not payment, is distribution, then the two dividends declared in 1916 must take the 1917 rate because not "distributions made in the year 1917 or thereafter," to which Section 31 applies.

That petitioner's theory that declaration is distribution leads to the result in this case that of the dividends paid in 1917 those declared in 1916 take the 1917 rate, while those declared in 1917 take the 1916 rate, a result which shows its lack of reason and justifies rejection.

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ARGUMENT

I

THE DIVIDENDS PAID IN 1917 SHOULD NOT BE TREATED AS PAID OUT OF 1917 EARNINGS, IF IT APPEARS THAT, IN FACT, AT THE DATE OF PAYMENT THERE WERE NO CURRENT EARNINGS, NOTWITHSTANDING THAT BEFORE THE CLOSE OF THE YEAR THERE WERE SUFFICIENT EARNINGS TO PAY SUCH DIVIDENDS

The Circuit Court of Appeals held that if the profits for the year 1917 disclosed at the end of the year were sufficient to cover the dividends paid during the year those dividends should be treated under Section 31(b) as paid out of 1917 earnings, notwithstanding it affirmatively appeared that at the date of payment no earnings had been made. This conclusion favored the Collector, and we submit the point, with the reasoning of the Circuit Court of Appeals to support it, for the decision of this Court, but we feel unable to urge this Court to affirm that decision.

The court below based its decision on the supposed authority of *Edwards* v. *Douglas,* 269 U. S. 204. While the decision in that case settled the point that the most recently accumulated undivided profits or surplus may be of the current year in which the distribution is made and not alone those accumulated up to the close of the preceding fiscal year, we think it was not decided that there need be no actual earnings for the current year at the date of distribution or that the earnings for the

year as a whole may be taken as a basis and prorated for the purpose of ascertaining current earnings available at the distribution date where there is affirmative evidence that no such current earnings in fact existed at the date of distribution. That case dealt with two dividends paid in September and December, 1917. The record in that case (pp. 32 and 33) shows that one dividend was declared September 13, to be paid September 28 to stockholders of record September 24, 1917. The other was declared December 13, to be paid December 28 to stockholders of record on December 18, 1917.

In that case the lower court had evidently proceeded on the theory that it was necessary to know whether current earnings were available at the date of payment of the dividends and, to ascertain that, had taken the earnings for the whole year and prorated them to determine the amount available at dates of distribution. It was not claimed in the brief for the United States that the 1917 distributions could be treated as paid out of 1917 earnings unless such earnings had been made prior to the distribution dates. There seemed to be no doubt on the record but that such earnings had been made and were available at the distribution dates. On the case as disclosed in that record the decision is authority for the proposition that a pro rata share of the entire year's earnings may be treated as approximating the actual earnings for a fraction of

the year, in the absence of circumstances showing that there were no earnings actually accumulated during the fractional period. It falls short of being authority for the claim that the unit and prorating method may be used where it affirmatively appears, as in this case, that no earnings were actually accumulated for the year until after the distributions were made. The decision left that question open. The point seems to have been carefully guarded and reserved for future consideration, because the opinion says (p. 208):

> There was no suggestion by the Douglas estate that, when these dividends were paid, the current undistributed 1917 earnings of the corporation then accrued were in fact insufficient to pay the two dividends. The District Court found that, under a pro rata apportionment, they were "more than sufficient." It is not suggested that the approximate amount of the undivided current earnings of 1917 accrued and undivided at the times these dividends were paid was not in fact known to be sufficient for this purpose. Nor is it suggested by the Douglas estate that the exact facts, or the knowledge thereof by the corporation at the times when the dividends were declared or paid, are of legal significance.

The purpose of the statute does not require a construction to the effect that a dividend paid during 1917 must be treated as paid out of 1917 earnings and bear the high 1917 rate, if when the dividend

was paid no such earnings were available for its payment. The object of the statute is accomplished if the dividend is treated as paid out of the earnings most recently accumulated in fact at the time of the payment, and does not require an assumption that the dividend was paid out of earnings which were not in fact made or accumulated until after the payment. The sound rule seems to be that the amount available out of current earnings for payment of dividends up to the actual date of distribution may be determined, where the method of accounting makes it possible by disclosing on the corporate books the approximate earnings in each month, by proof in that form, and if that kind of evidence is not available the amount of current earnings at any particular period in the year may properly be taken to be a pro rata share of the entire year's earnings, provided there is nothing persuasive to show that the fact is otherwise or the method inaccurate.

Besides, the contrary rule would conflict with the regulations and practice of the Treasury Department from the time when the law of 1917 went into effect until the Circuit Court of Appeals rendered its decision in this case. Article 107 of Regulations 33, Revised, issued January 2, 1918, was as follows (pp. 61–62):

> If a corporation distributed dividends in 1917, such dividends will be deemed to have been paid from the earnings of 1917, and the

> recipient, if an individual, will be liable to additional tax, if any, and if a corporation, to income tax, at the rates for the year 1917, unless it is shown to the satisfaction of the Commissioner of Internal Revenue *that at the time such dividends were paid, the earnings up to that time were not sufficient to cover the distribution,* in which case the excess over the earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years, and will be taxed at the rate or rates for the year or years in which earned. (Italics ours.)

By this regulation the Bureau of Internal Revenue adopted the view that it was necessary to know the current earnings up to the date of distribution and that earnings after that date could not be treated as applicable to the distribution. That interpretation of the law has been followed consistently by the Treasury Department down to the date of the decision of the Circuit Court of Appeals in this case. We are not able to see any good reason for disturbing the settled practice of the Treasury Department.

Again, the idea that only earnings actually made up to date of distribution could be considered was immediately accepted by Congress in enacting the Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1060, in Section 201(e), which was as follows:

> Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period.

Although the 1918 Act repealed the provision of the 1917 Act we are considering, and Section 201 (e) was useful principally in determining whether invested capital had been reduced by dividends, the section may also have been intended to determine what year's profits stock dividends (dealt with in Section 201 (d) on the theory they were taxable as income) were paid from, and in any event shows the ready acquiescence of Congress in the construction of the 1917 Act theretofore adopted by the Treasury Department.

This is also a plain case for the application of the rule that doubt of the meaning of a taxing statute should be resolved in favor of the taxpayer.

II

ACCEPTING THE COLLECTOR'S VIEW THAT THE DATE OF THE DISTRIBUTION REFERRED TO IN THE STATUTE IS THE DATE OF PAYMENT AND NOT THE DATE OF DECLARATION OF THE DIVIDEND, THERE WERE NO 1917 EARNINGS AVAILABLE ON THE DATES OF DISTRIBUTION

Assuming that only actual current earnings to date of distribution and not those accumulated subsequent to distribution during the same fiscal year may be treated as the source of the distribution, and assuming, also, that a distribution is made within the meaning of the statute when the dividend is paid and not when it is declared, the question of fact arises in this case whether at the respective dates of payment of the dividends there were any current 1917 earnings. This case was determined on stipulated facts (R. 6), which were adopted as the findings of the court (R. 16). It appears from that stipulation that The B. F. Goodrich Company, for special reasons present in 1917, shipped out to dealers large quantities of tires, under contracts, which provided (R. 9) that in September and October dealers should have the privilege of returning the tires in good order which they had not disposed of. By subsequent arrangement the dealers were required to determine by August 15, 1917, what tires they desired to return. (R. 11.) While the corporation immediately on the shipment set up the selling price of the tires in accounts receivable, keeping its books on an accrual basis (R. 14), at

the end of the year, or as soon as tires were returned, the amount of the accounts receivable were reduced on the books in accordance with the quantity of tires returned. The stipulation states (R. 14):

> It is agreed that if, upon the execution of the special contract between The B. F. Goodrich Company and its dealers, hereinabove set forth, deliveries of tires thereunder at once became and constituted firm sales, the Company had on the dates of payment of dividends here in question profits, earned but not received, for the year 1917 equal to or in excess of the amount of said dividends; but if the deliveries under said special contract did not constitute firm sales, the Company did not have any profits for such year on the dates of the payment of the dividends here in question.

The stipulation is in many respects inadequate and unsatisfactory. It is obvious that whether or not a sale was a firm sale on delivery of the tire to the dealer, it became such when the dealer sold or used the tire. There is nothing in the stipulation indicating what tires had been actually disposed of by dealers prior to the dividend-payment dates, and we can not resist the conclusion, taking the stipulation as a whole, that if this subject had been gone into valuable information would have been obtained; but we must take the stipulation as we find it, and we can not assert that a sale was a firm sale at a time when the dealer had a right, at his own

pleasure, to return the merchandise, and in the face of the express terms of this stipulation we can not see how it can be contended that on the dates of payment of these dividends any 1917 earnings had in fact been made. It may seem that this disposes of the case and makes it unnecessary to consider whether a distribution was made within the meaning of the statute when the dividend was paid or when it was declared, but this is not so, and it is necessary to pass on the point for the reasons disclosed in the next portion of this brief.

III

A DISTRIBUTION WAS MADE WITHIN THE MEANING OF THE STATUTE NOT WHEN THE RESOLUTION WAS PASSED DECLARING THE DIVIDEND BUT WHEN PAYMENT WAS MADE TO THE STOCKHOLDERS

The decision in *Edwards* v. *Douglas, supra,* does not dispose of this point. In that case, since so short a time elapsed between declaration and payment and both events occurred in the same year, the question whether the date of declaration or date of payment should be considered as the date of distribution was not important and was not presented or decided. The opinion speaks of the date of payment as the date of distribution, and thus, we think, naturally adopted the ordinary meaning of the word "distribution," but it can not be said that the point was involved or decided.

It is evident that Congress intended that the source of any dividend should be considered the earnings accumulated last in point of time, and prior to the date of distribution, and the question for decision is whether that means prior to the date of declaration or prior to the date of payment.

It may be admitted that the intention of Congress as to the meaning of the words "distribution made" is not clear. This uncertainty may not be disposed of by applying the rule that ambiguities in tax statutes are to be resolved in favor of the taxpayer, because some taxpayers would be benefited by one interpretation and other taxpayers by the other, depending upon their peculiar circumstances. In the case at bar, for instance, it would be to the advantage of the petitioner, under the particular facts of this case, if it were held that the date of payment is the date of distribution, as will be pointed out shortly. It is therefore necessary to consider everything which points to the probable intention of Congress.

The petitioner's principal argument is that, ordinarily, the declaration of a dividend fixes the rights of the stockholder as between him and the corporation and creates a debt of the corporation, and that in declaring a dividend the available surplus at the time of declaration must be the basis. This is all true enough, but these matters have no direct relation to the purpose of the statute here under consideration or to the problem here dealt with.

Another argument, largely relied on by the petitioner, is based on the last sentence in subdivision (b) of Section 31 to the effect that—

> This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

The petitioner points out that this sentence was added to protect those who had made distributions in good faith prior to August 6, 1917 (the date when the proposed retroactive provisions of Section 31 were made public), by resolutions declaring that the dividends should be considered payable out of profits accrued prior to March 1, 1913, in reliance on existing law, the 1916 Act, which allowed such dividends free of tax to the stockholders if the board of directors specified that the dividends should be paid out of the profits accrued prior to March 1, 1913, even though there were available profits accumulated later. It is urged that if the words "distribution made" be construed to refer to the date of payment rather than to the date of declaration, the purpose of this last sentence in subdivision (b) would be defeated, in that it would fail to protect those who declared dividends prior to August 6th payable after that date. This argument has some force, but it proceeds on the assumption that such a resolution declaring a dividend would have been irrevocable, and this can not be conceded.

Generally speaking, an absolute and unconditional declaration of a dividend, not made under mistake or misapprehension, creates a right in the stockholder and is not subject to rescission by the corporation; but there are exceptions to this rule, and if a board of directors of a corporation, prior to August 6, 1917, proceeding on the assumption that under existing statutes they could declare a tax-free dividend to their stockholders out of profits accumulated prior to March 1, 1913, had passed a resolution to that effect specifying that the dividends should be treated as paid out of such profits, and had by their resolution deferred the actual payment until after August 6th, and then learned that a bill was pending in Congress and about to become law which would retroactively repeal the statute under which they had acted, nullifying the effect of their specification of the profits out of which the dividends were to be paid and defeating the purpose of the resolution by making the dividend subject to an enormous income tax instead of being tax free as contemplated, we have no doubt that a rescission of the dividend resolution by the board prior to the payment date would have been proper and sustained by any court. This subject is too remote from the questions here involved to justify further consideration. Something on the subject will be found in Thompson on Corporations, 3d Ed., Vol. 7, Section 5276. If such a resolution was revocable when pending legislation became public on

August 6th, the entire argument of the petitioner along this line fails.

Considerations which support the view that the distribution was made, within the meaning of this statute, when the dividend was paid and not when it was declared, are as follows:

(1) The words "distribution made" in their ordinary sense convey the idea that the money or property has been actually distributed in the sense of being placed in the hands of the distributee. The brief of *amici curiae* has furnished an illustration of such use in citing (p. 7) Section 58 of the New York stock corporation law. That section is as follows:

> No stock corporation shall declare or pay any dividend which shall impair its capital or capital stock, nor while its capital or capital stock is impaired, nor shall any such corporation declare or pay any dividend or make any distribution of assets to any of its stockholders, whether upon a reduction of the number of its shares or of its capital or capital stock, unless the value of its assets remaining after the payment of such dividend, or after such distribution of assets, as the case may be, shall be at least equal to the aggregate amount of its debts and liabilities including capital or capital stock as the case may be. In case any such dividend shall be paid, or any such distribution of assets made, the directors in whose administration the same shall have been declared or made, except those who may have caused their dissent therefrom to be entered upon

> the minutes of the meetings of directors at the time or who were not present when such action was taken, shall be liable jointly and severally to such corporation and to the creditors thereof to the full amount of any loss sustained by such corporation or by its creditors respectively by reason of such dividend or distribution.

Here the expression "make any distribution" and the word "distribution" are plainly used as applying not to the declaration of the dividend but to the actual delivery of assets to the stockholders. In that section the New York Legislature has used the term "distribution" in the sense contended for by the United States in this case. The section also suggests that the reason Congress used the term "distribution made" instead of "dividend paid" was because the term "dividend paid" was more appropriate to a dividend paid in money, and some dividends are in property, and the term "distribution made" would be broad enough to include both.

(2) The purpose of the statute is best served by treating a dividend as paid out of current earnings available when it was actually paid. The purpose of the statute was to treat all dividends as paid out of the very latest earnings available, and this purpose would be defeated if dividends declared early in 1917, long before the dates fixed for their payment, would escape the high 1917 rate because there were no current earnings available at declaration, although such earnings were in hand when the time

of payment arrived and were actually then available for payment. Such a construction would have opened the doors wide to evasion.

The law was not in force long enough for that to be attempted, but that does not weaken the force of the argument. Many corporations declare dividends long in advance of the payment dates. Surplus funds, which form the basis for declaration of dividends, are frequently nonliquid because invested in plant, equipment, or materials. Deferring payment of a dividend is often for the purpose of waiting for cash out of current earnings. There is no reason why the stockholders of one corporation having current earnings in June, 1917, should escape with the 1916 rate on a dividend declared January 2, 1917, and payable June 30, while the stockholders of another corporation, under similar conditions, are forced to pay the 1917 rate because their dividend was declared June 30 and paid the same date. Inequalities resulting from taking the date of declaration are well illustrated by the case of *A. H. Stange* (1 B. T. A. 810), where a dividend was declared on January 27, 1917, the amount being stated in the resolution "to be paid to the stockholders when and as directed by officers or directors." Portions of this amount were paid in August, 1917, and some not until 1918 and 1919. This decision, cited by the petitioner, is plainly unsound on any theory for the reason that the declaration never became final or effective until such time as the officers or directors took further

action; but, aside from that, it discloses the defeat of the purpose of the statute under consideration where the passage of a resolution declaring a dividend is treated as the making of the distribution.

3. From the beginning the Treasury Department construed the statute to mean that the distribution is made when the dividend is paid. Article 107 of Treasury Regulations No. 33 (above quoted), relied upon to show the practice of the Department on the other point involved in this case, treats the payment of the dividend as the distribution. Until the Board of Tax Appeals decided the *Stange* case in 1925 this Regulation was applied and enforced uniformly. The decision of the Board of Tax Appeals in the *Stange* case and in the other cases following it, cited by the petitioner, are now being contested in the courts by the Bureau of Internal Revenue. No argument has been adduced by the petitioner persuasive enough to justify rejecting the interpretation of this statute which was promptly adopted by the Treasury Department announced in its Regulations, and applied over a long term of years to innumerable cases.

4. The statute makes a dividend income to the stockholder when received, not when declared, and it seems inconsistent to speak of a distribution as having been made before the stockholder gets it as income. One who, under the 1916 Act, kept his accounts and made his returns on a cash basis would not deal with dividends as income until received, and we doubt if it has ever been customary for a

stockholder keeping his accounts on an accrual basis to enter up as an accrued account receivable the amount of dividends declared on his stock, discounted to present worth, immediately on the declaration of the dividend, and before payment.

5. In subdivision (a) of Section 31 it is said:

> That the term "dividends" as used in this title shall be held to mean any *distribution made or ordered to be made* by a corporation * * *.

The words we have italicized suggest that Congress understood a dividend paid to be a distribution made and a dividend declared to be a distribution ordered. In subdivision (b) only the words "distribution made" were used, and the phrase "distribution ordered to be made" was omitted. This argument, while not convincing, has some force.

6. The term "distribution made" is used in several places in Section 31(a) and (b). The words should not be given different meanings where used in different parts of the statute. Subdivision (b) provides:

> Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus,

and shall be taxed at the rate prescribed by law for the years in which the profits were accumulated. The special provision of this statute giving the benefit of the tax rate in effect when the surplus was accumulated *applies only to distributions made in the year 1917 and thereafter.* A distribution made in 1916 is not within the terms of the section.

Two of the dividends involved in this case were declared in 1916, payable in 1917. If the petitioner is right in contending that the distribution is made within the meaning of this statute when the dividend is declared, then these two distributions were made in 1916 and Section 31 (b) does not apply to them, and there is no statute applicable to those distributions changing the ordinary rule that the rate of taxation is that for the year in which the dividend is received and for which the return is made. The petitioner's brief is silent on this subject, although the point was raised in the Government's brief at the time of the application for certiorari. Under the petitioner's theory that a distribution is made within the meaning of the statute when the dividend is declared, a dividend declared December 31, 1916, payable March 1, 1917, would be subject to the general rule and take the 1917 tax rate, notwithstanding the corporation had no earnings for 1917, while if the dividend were declared January 2, 1917, payable March 1, 1917, under Section 31 (b) the dividend would take the 1916 or an earlier rate, there being no 1917 earnings, and in the case at bar, on petitioner's theory that declaration is distribu-

tion, dividends declared in 1916 payable in 1917 take the 1917 rate, while those declared in 1917 paid that year take the 1916 rate. When it comes to testing the respective position of the parties by incongruous results, no illustration or suggestion made by the petitioner attacking the operation of the rule the Collector contends for, is so striking as this. Congress certainly did not intend such a result.

In this connection it will be noted that in the present case it would be to the advantage of the United States to have the rule adopted that declaration is distribution, because under that rule two of the dividends here involved declared in 1916 would certainly take the 1917 rate because not covered by Section 31, whereas under the rule that payment is distribution all of these dividends will take the 1916 rate, if we are right in our suggestion that only earnings accrued prior to the actual payment are treated as distributed. The petitioner in arguing that declaration and not payment is distribution seems to be contending against his own interest.

The interest of the United States is not to win this case but to have rules adopted for general application which are sound and consistent with the statute, and which will not disturb the established practice of the Bureau of Internal Revenue and reopen large numbers of cases under a statute long since repealed.

CONCLUSION

If this Court adopts the views of the Circuit Court of Appeals in all respects the result will be an affirmance. If it is held that only earnings actually accrued for 1917 up to the dates of distribution should be treated as the source of the distributions, and it is also held that payment is distribution, the judgment will have to be reversed and the recovery awarded by the District Court affirmed. If only earnings actually accrued for 1917 up to the dates of the distributions are treated as their source, but the declaration of the dividend and not the payment is considered the distribution date, then neither the judgment of the Circuit Court of Appeals nor the District Court would be accepted, and the case would have to be remanded with instructions to proceed on the theory that the dividends declared in 1917 are to take the 1916 rate, but the dividends declared in 1916, not being covered by Section 31, are to take the 1917 rate.

Respectfully submitted.

WILLIAM D. MITCHELL,
Solicitor General.

SEPTEMBER, 1927.

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SUPREME COURT OF THE UNITED STATES.

No. 152.—October Term, 1927.

F. H. Mason, Petitioner, *vs.* C. F. Routzahn, Collector of Internal Revenue.	On Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[November 21, 1927.]

Mr. Justice Brandeis delivered the opinion of the Court.

Section 31 (b), which was added to the Revenue Act of 1916 by the Revenue Act of 1917, October 13, 1917, c. 63, Title XII, 40 Stat. 300, 338, provides that any "distribution made to the shareholders . . in the year nineteen hundred and seventeen, or subsequent tax years, . . shall constitute a part of the annual income of the distributee for the year in which received," but that it "shall be deemed to have been made from the most recently accumulated profits or surplus . . . and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits were accumulated." See *Edwards* v. *Douglas*, 269 U. S. 204.

Mason, a shareholder in the B. F. Goodrich Company, received during the year 1917, five dividends prior to July 3. Two of them had been declared in the year 1916; three in January, 1917. In his income tax return for 1917, he reported all these dividends as taxable at the 1916 rate, and paid on that basis. The Commissioner of Internal Revenue determined that the tax on all these dividends was payable at the 1917 rate, which was higher than that for 1916; and assessed the additional amount. It was paid under protest. Then this suit was brought against the Collector, in the federal court for northern Ohio, to recover the amount exacted. The case was heard without a jury upon stipulated facts, which were adopted by the court as its findings. The District Court entered judgment for Mason for the full amount, 8 F. (2d) 56. Its judg-

ment was reversed by the Circuit Court of Appeals, 13 F. (2d) 702. This Court granted a writ of certiorari, 273 U. S. 687.

The Government admits that no profits were earned in 1917 prior to the payment of the dividends here in question. Mason claims, as to two of the dividends, that the 1916 rate applied, because the dividends had been declared in that year; and as to all the dividends, that the 1916 rate applied, since the corporation had not earned in 1917 any net profits prior to the dates of the several dividend payments, so that the most recently accumulated net profits were those earned in the year 1916, which were more than sufficient for this purpose.

The District Court held that, despite the fact that the profits for 1917 were in excess of all dividends paid in that year, the distribution must be deemed to have been made out of profits accumulated in 1916; and entered judgment for the full amount. Thereafter, and before this case was heard in the Court of Appeals, *Edwards* v. *Douglas* was decided by this Court. The Court of Appeals recognized that *Edwards* v. *Douglas* differed in its facts from the case at bar. But it concluded that, under the reasoning of the opinion in that case, the taxing year should be treated as a unit; and it believed that it was required to hold that, if the net profits of a whole year prove sufficient to meet all the dividends paid within it, these must be deemed to have been paid from such profits, even if it affirmatively appears that none had been earned before the date when the latest dividend was paid.

The Solicitor General concedes that *Edwards* v. *Douglas* does not so decide; that the case is authority only for the proposition that a pro rata share of the entire year's earnings may be treated as approximating the actual earnings for the fraction of the year prior to the payment of the dividend in the absence of circumstances showing that there were no earnings actually accumulated during the fractional period; that the amount actually available for payment of dividends out of the current year's earnings prior to the date of payment may always be shown; that such had been the practice of the Treasury Department from the time the Revenue Act of 1917 took effect until the date of the Court of Appeals' decision; and that this rule was embodied in its regulations.

We see no good reason for disturbing the long settled practice of the Treasury Department. Its contemporary interpretation is consistent with the language of the Act; and its practice was, in substance, embodied in the Revenue Act of 1918, February 24, 1919, c. 18, § 201 (e), 40 Stat. 1057, 1060. We conclude that the Circuit Court of Appeals placed an erroneous construction on § 31 (b).

Since two of the dividends paid in 1917 were declared in 1916, it becomes necessary for us to consider whether these also are to be deemed distributions made in 1917, as it is only to such that the section applies. It declares that the dividend is income of the shareholders in the year in which it is "received." We think it clear that, for this purpose, the date of payment, not the date of the declaration of the dividend, is the date of distribution; and as all the dividends here in question were paid in 1917, the provision as to the rate is applicable to all. As there were no earnings in 1917 prior to the dates of the payments, and as there were confessedly ample accumulated earnings of 1916 prior to the declaration of the several dividends, we have no occasion to consider other questions which were argued. The judgment of the Circuit Court of Appeals is reversed; that of the District Court is affirmed.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.